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SUPREME COURT OF THE UNITED STATES

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OCTOBER TERM, 1951

No. 550

AUGUSTO R. SOLTERO,

Petitioner,

v.

SOL LUIS DESCARTES, TREASURER OF PUERTO RICO, ET AL.,

Respondents

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT AND BRIEF IN SUPPORT THEREOF

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Respondents

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT.

May it please the Court:

The petitioner, Augusto R. Soltero, a sugar cane farmer, respectfully petitions this Honorable Court for a writ of certiorari to the United States Court of Appeals for the First Circuit.

Summary Statement of the Matter Involved

This case involves the validity of a particular post-mortem application of a Puerto Rican gross income tax statute to the "conditional payments" received by sugar growers and producers pursuant to the provisions of the

Sugar Act of 1937 (7 U.S.C.A. 1100 et seq.). The constitutionality of such tax imposition is contested on the ground that in substance and effect it is a burden or interference with a Congressionally devised method for stabilizing and fostering interstate and foreign sugar commerce and of preventing ruinous competition in it. Further, the taxing act is opposed on the ground that it unduly discriminates against individuals and in favor of artificial persons, imposing the levy exclusively on the "conditional payments" received by individual sugar farmers and producers while unjustifiably exempting from the tribute the same "conditional payments" when received by artificial persons engaged in exactly the same activity.

The petitioner grew sugar cane and ground it into sugar during the years 1942 to 1945. All the sugar thus produced was sold to Commodity Credit Corporation for shipment in interstate and foreign commerce. During those years there was a statute in force in Puerto Rico, denominated the Victory Tax Act,[1] which levied a 5% tax upon the gross income of every individual in the Island, in addition to the general net income tax. The Victory Tax Act was repealed in 1945, no attempt having been made to apply the levy to "conditional payments". But after the repeal, the Treasurer of Puerto Rico assessed tax deficiencies on the "conditional payments" received during the years 1942-1945 by all individual sugar growers and producers. Thus arose the present controversy, a test case affecting the interests of thousands of individual growers and producers.

After a trial on the merits, the insular Tax Court held that the conditional payments provided for in the Sugar Act constitute, if not totally, at least in part, a reimburse-

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[1] The act was originally enacted December 7, 1942 and was amended on May 10 and May 15, 1943. Its relevant sections are set out in the Appendix to the Brief in Support of this Petition.

ment to sugar cane producers, calculated by Congress to compensate them for the added expenses incurred in complying with the conditions set forth in Section 301 of the Act (R. 240-). As it had previously decided that income of this nature was not taxable under the terms of the Victory Tax Act, and since that statute specifically exempts all reimbursements, it entered judgment for petitioner (R. 241).

Upon review, the judgment was vacated by the Supreme Court of Puerto Rico and the case remanded to the Tax Court with specific instructions to decide "why the conditional payments . . . constitute . . . under . . . the Act, a reimbursement . . . of the expense incurred . . . by reason of the Sugar Act of 1937." (R. 244.) Additional instructions enjoined the Tax Court to decide, if necessary, the other questions presented by petitioner, "such as if the said payments are derived from a contract of sale; *whether the Victory Tax is void for unconstitutionality as applied to payments authorized by a federal statute;* and whether the Treasurer was authorized to collect the tax after Act No. 175 of 1943 was repealed." (R. 244.)

By stipulation, the case was re-submitted to the Tax Court on the record of the first hearing (R. 246). That Court found itself unable to determine upon the evidence "what portion of the so-called conditional payments corresponds to the reimbursement of the additional cost incurred by the petitioner" in complying with the pertinent provisions of the Sugar Act (R. 248), and, inexplicably ignoring the higher court's instructions as to the decision of the other questions involved, proceeded forthwith to enter judgment dismissing the complaint (R. 248-249).

The Supreme Court of Puerto Rico again granted certiorari. Extended briefs were filed on the constitutional questions posed and the parties orally argued the matter very thoroughly (R. 278). Surprisingly enough, however, the

Supreme Court of Puerto Rico affirmed the Tax Court's decision without deciding itself the constitutional questions involved, the very questions which it had explicitly instructed the Tax Court to consider and decide.

On appeal by petitioner, the United States Court of Appeals for the First Circuit affirmed the Puerto Rican judgment, stating that, although Congress has the power to annul the acts of the insular legislature, should their operation impinge upon interstate commerce, it had not annulled the Victory Tax Act, nor prohibited the Act's taxation of the conditional payments under the Sugar Act. It further indicated that "subsidies" (sic) somewhat like these payments are properly taxable *under the federal tax law,* and that "there is no clear and convincing evidence that this Victory Tax thwarts the Sugar Act of 1937 so as to defeat congressional policy" (R. 304). Finally, it held that the discrimination made by the act against individuals and in favor of artificial entities is not unreasonable, such distinction not being unusual in the federal tax structure (R. 305).

Three parts of the opinion of the Court of Appeals emphasize the issues here made by petitioner:—

1. That Court held that since Congress has the power to annul the acts of the insular legislature, the fact that it has not annulled the Victory Tax Act, nor prohibited that Act's taxation of the conditional payments under the Sugar Act, shows effectively that the taxing act does not impinge upon interstate commerce (R. 303-304). This ground of decision has repeatedly been disapproved by this Court.

2. The Court of Appeals further held that the tax sought to be applied in this case partakes more of the nature of a net income tax than of a tax on gross income or on gross receipts, in view of the deductions allowed, and that a tax on net income is not a burden on interstate commerce (R. 304). But the Court below overlooked the crucial fact that

this case does not involve the validity of the Victory Tax Act, already repealed. It only questions the constitutionality of a particular application of the statute, whereby the full tax is assessed on the total amounts received by petitioner as conditional payments. Thus, this application of the taxing act implies a tribute or levy on gross income or gross receipts.

3. The court below, in holding that the distinction made by the taxing act between individuals and artificial persons is not oppressive or discriminatory, indicated that such distinction is not unusual in the federal tax structure, and that it is conceivable that the Puerto Rican Legislature considered this tax measure as an anti-inflation device during the war period. But independently of the obvious fact that as an anti-inflation device the taxing act should have been made applicable both to natural and artificial persons, this Court has held that the imposition of a tax on the gross receipts of corporations operating a certain business, when it is not imposed upon individuals and partnerships engaged in the same business, unconstitutionally deprives corporations of the equal protection of the laws. And the converse of the proposition has also been approved by this Court.

This Court Has Jurisdiction

The jurisdiction of this Court is invoked under section 1254 of the Judicial Code (28 U.S.C.A. 1254). Judgment was entered in this case by the United States Court of Appeals for the First Circuit on November 8, 1951.

There is no question of local law here involved, nor of the power of the insular legislature, under the Organic Act of Puerto Rico, to levy or collect income taxes or any other tax. Petitioner attacks as unconstitutional a *particular application* of the Victory Tax Act which would materially reduce the amount of the conditional payments specifically

provided for by a Congressional enactment intended to regulate and foster interstate and foreign commerce.

The case thus involves an important question of federal law which has not been, but should be, settled by this Court. This Court, so far as petitioner is informed, has never decided whether a territory—or a State—may validly levy a gross income tax on the conditional payments provided for in the Sugar Act of 1937, thereby reducing the specific amount of such payments as prescribed by Congress.

The federal constitutional issues are properly preserved and the Court of Appeals passed on all of said issues.

The Questions Presented

1. Whether a Puerto Rican tax measured, in this particular application thereof, by the gross receipts of petitioner from the conditional payments provided for in the Sugar Act of 1937, is a burden on the scheme of regulation and stabilization of the foreign and domestic sugar market attempted to be set up by Congress through the enactment of the Sugar Act of 1937.

2. The issue is also presented as to whether Puerto Rico has the right, under the provisions of the equal protection clause of its Organic Act (48 U.S.C.A. 731 et seq) and of the Fourteenth Amendment, to assess a gross income tax on conditional payments received by individual sugar growers and producers, when the identical income received by artificial persons, like corporations, partnerships, successions, trusts, joint ventures, etc., is exempted from the tax, even though such artificial persons are engaged in the same activity and receive conditional payments from the same source, computed at the same rates and by the same methods, and paid upon compliance with the same conditions.

3. A final issue is also presented, i. e., whether Puerto Rico may validly levy an unapportioned gross income tax on

the proceeds of sales of sugar grown and produced by petitioner to be sold for immediate and direct shipment in interstate and foreign commerce, in compliance with regulations issued by the Secretary of Agriculture under the Sugar Act intended to assure the successful operation of the quota system prescribed in the Sugar Act.

Reasons Relied On for Allowance of the Writ

1. The decision of the Court of Appeals as to the validity of a local gross income tax applied to the conditional payments provided for in the Sugar Act of 1937 involves an important question of federal law which has not been, but should be, settled by this Court. Perhaps the question was intimated in *State Tax Commission* v. *Kennecott Copper Corporation,* 327 U. S. 573, 90 L. ed. 862, but no decision was made on the point at all.

In the Sugar Act Congress specifically provided for a payment of 80 cents per hundred pounds of sugar to producers who comply with the conditions set forth in that statute. This base rate was not loosely arrived at. It was the result of an extensive congressional investigation of costs of sugar production in the different producing areas supplying the domestic market, as well as of the economic impact of the sugar import duties. Puerto Rico is now seeking to uphold an application of its Victory Tax Act which would effectively reduce the payments from 80 cents per hundred pounds to 76 cents per hundred pounds. Should every state and territory levy a similar gross income tax on these payments, in differing rates and terms, it is easy to realize that the value of the conditional payments as "a Federal method of fostering interstate and foreign commerce and preventing ruinous competition in it" (House Report No. 1179, 75th Congress, First Session, Legislative Report of July 2, 1937) would be seriously impaired. Both the conditional pay-

ments and the quota system, set up in the Sugar Act as the two controlling media or instruments to carry into effect the declared policy of Congress as to the orderly marketing of sugar in foreign and interstate commerce, would be palpably affected.

2. The decision of the Court of Appeals as to the taxing act's discrimination between individuals and artificial persons, by holding that such discrimination is not oppressive nor unreasonable, is a decision of a federal question in a way probably in conflict with applicable decisions of this Court. In *Quaker City Cab Co.* v. *Pennsylvania,* 277 U. S. 398, 72 L. ed. 927, this Court stated with reference to such discrimination that "In no view can it be held to have more than an arbitrary basis." (277 U. S. at p. 402.) And in *Frost* v. *Corporation Commission,* 278 U. S. 515, 73 L. ed. 483, this Court warned that "A classification which is bad because it arbitrarily favors the individual as against the corporation cannot be good when it favors the corporation as against the individual." (278 U. S. at p. 522.)

Respectfully submitted,

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Petitioner,

vs.

SOL LUIS DESCARTES, TREASURER OF PUERTO RICO, ET AL.,

Respondents

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Opinion Below

The opinion of the United States Court of Appeals for the First Circuit is reported in 192 F. (2d) . The opinion is also printed in full in the Record, pp. 296-305.

Jurisdiction

The jurisdiction of this Court is invoked under section 1254(1) of the Judicial Code (28 U.S.C.A. 1254). The Court of Appeals has in this case decided an important question of federal law which has not been, but should be, settled by this Court. Further, the Court of Appeals has decided a federal question in a way probably in conflict with applicable decisions of this Court.

Judgment was entered in this case by the Court of Appeals for the First Circuit on November 8, 1951 (R. 306).

Statement of the Case

Petitioner, a grower and producer of sugar in Puerto Rico, has during the last thirteen years (R. 16) ground and processed his cane into sugar at a mill near San Juan pursuant to an agreement whereby the mill gets thirty-five per cent of the sugar so obtained (R. 47, 189). The remaining sixty-five per cent belongs to petitioner and is customarily left at the mill with instructions that it be sold to Commodity Credit Corporation, a corporate agency of the United States (R. 17, 18, 37, 50). All of petitioner's sugar has been so sold during at least ten years (R. 53-54).

Inasmuch as all the sugar thus produced during the years 1943-45 was sold to Commodity in conformity with the provisions of the Sugar Act of 1937 (7 U.S.C.A. 1100 et seq.), petitioner received the basic contractual price plus the conditional payments provided for in said statute. Accordingly, during those years petitioner was paid not only the contractual basic minimum price of $3.46 per hundred pounds, but also the further sum of 80 cents per hundred pounds of sugar marketed.[1] (Plaintiff's Exhibits 1-3, admitted at R. 18-20.) These payments were made to him upon applications certifying, among other data, the sugar commercially recoverable from sugar cane marketed or processed during those crop years by petitioner, the sugar actually produced pursuant to Sugar Determination No. 190, issued by the War Food Administrator on April 11, 1944, and the tonnage of sugar cane marketed for sugar (Plaintiff's Exhibit 1, R. 89).

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[1] 7 USCA 1134, as amended December 26, 1941, 55 Stat. 873. Prior to 1941 this payment amounted to 60 cents per hundred pounds, 50 Stat. 911.

Title III of the Sugar Act prescribes several conditions which must be complied with by producers to entitle them to the payments. Child labor is prohibited, laborers must be paid the wages determined by the Secretary of Agriculture, and certain farming practices must be carried out in connection with the production of sugar cane, including the planting of certain food crops and the application of soil erosion preventive measures. Of particular importance here is the specific requirement that there shall not have been marketed or processed an amount of sugar cane used for the production of sugar in, or so as to compete with or otherwise directly affect, interstate or foreign commerce in excess of the proportionate share for the farm as determined by the Secretary of Agriculture (7 U.S.C.A. 1131c).

Petitioner complied fully with all the statutory conditions and payments amounting to $881.17 in 1942, $1389.45 in 1943, and $1224.72 in 1944 were duly made to him by the Secretary (R. 87, 94-95).

During those years there was a statute in force in Puerto Rico which levied a 5% tax upon the gross income of every individual in the Island.[2] But during all the time the act was in force, the Treasurer did not construe it as applicable to the conditional payments authorized by the Sugar Act. Accordingly, no attempt was made during that time to levy or collect the tax on said payments (R. 84).

On May 15, 1945 the statute was repealed (Laws of Puerto Rico, 1945, p. 1265), and four months later petitioner was directed to file additional returns for, and to pay the tax on, the amounts received in the years 1943-45 as conditional payments (R. 228-229). Upon his refusal to do so, the Treasurer assessed deficiencies in the 1943-45 taxes con-

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[2] This tax was denominated "the Victory Tax." It was originally enacted on December 7, 1942 and subsequently amended on May 10 and May 15, 1943. (Laws P.R., 1942, No. 29; Laws P.R., 1943, pp. 146 and 630.) The relevant sections of the Act are set out in the Appendix.

sisting exclusively of the unpaid tax on conditional payments, with interest and penalties. Petitioner's motion for reconsideration was administratively denied and this proceeding was then initiated in the Tax Court of Puerto Rico.

After a trial on the merits, the insular Tax Court held that the conditional payments constitute, if not totally, at least in part, a reimbursement to sugar cane producers, calculated by Congress to compensate them for the added expense incurred in complying with the conditions set forth in Section 301 of the Act (R. 240). As it had previously decided that income of this nature was not taxable under the terms of the Victory Tax Act, and since that statute specifically exempts all reimbursements, it entered judgment for petitioner (R. 241).

Upon review, the judgment was vacated by the Supreme Court of Puerto Rico and the case remanded to the Tax Court with specific instructions to decide "why the conditional payments . . . constituted . . . under . . . the Act, a reimbursement . . . of the expense incurred . . . by reason of the Sugar Act of 1937." (R. 244.) Additional instructions enjoined the Tax Court to decide, if necessary, the other questions presented by petitioner, "such as if the said payments are derived from a contract of sale; *whether the Victory Tax is void for unconstitutionality as applied to payments authorized by a federal statute;* and whether the Treasurer was authorized to collect the tax after Act No. 175 of 1943 was repealed." (R. 244.)

By stipulation, the case was re-submitted to the Tax Court on the record of the first hearing (R. 246). That court found itself unable to determine upon the evidence "what portion of the so-called conditional payments corresponds to the reimbursement of the additional cost incurred by petitioner" in complying with the pertinent provisions of the Sugar Act (R. 248), and inexplicably ignoring the higher court's in-

structions as to the decision of the other questions involved, proceeded forthwith to enter judgment dismissing the complaint (R. 248-249).

The Supreme Court of Puerto Rico granted certiorari. Extended briefs were filed on the constitutional questions posed and the parties argued the matter very thoroughly (R. 278). Surprisingly enough, however, the Supreme Court of Puerto Rico affirmed the Tax Court's judgment *without deciding itself the constitutional questions involved,* the very questions which it had explicitly instructed the Tax Court to consider and decide.

On appeal, the United States Court of Appeals for the First Circuit affirmed. It held, in substance, that there is no evidence that the Puerto Rican Victory Tax Act thwarts the Sugar Act of 1937 so as to defeat congressional policy; that the act's discrimination between individuals and artificial persons is not unusual in the federal tax structure and is thus not unreasonable; and that, since Congress, having the power to do so, has not annulled the insular taxing act, it could not hold that said act's operation impinged upon interstate commerce (R. 303-305).

There is no doubt that (1) your petitioner grew sugar cane and produced sugar exclusively for direct and immediate shipment in interstate and foreign commerce; (2) that in the cultivation of the cane and in the production of its resultant sugar, petitioner was subject to, and actually fully complied with, all the conditions or requisites set forth by Congress in Title III of the Sugar Act of 1937; (3) that in consequence thereof, petitioner received certain sums of money as conditional payments under the Sugar Act; (4) that the fiscal authorities of Puerto Rico are now endeavoring to collect from petitioner a full 5% of said sums in an attempted post-mortem application of the Victory Tax Act, the tax being laid upon the total amount of the conditional

payments received by petitioner; and (5) that the tax is not levied on, nor attempted to be collected from, any other growers or producers operating as artificial persons, viz, from corporations, partnerships, trusts, joint ventures, successions, etc., even though such artificial entities are engaged in the same activity and consequently received conditional payments under the Sugar Act.

Your petitioner takes the position that by the tax discrimination thus made the equal protection of the laws is denied to him and to all other individual growers and producers of sugar in Puerto Rico; that the particular application here sought to be validated of the insular tax enactment, by taking for the use of Puerto Rico a part of every dollar allotted by Congress to sugar producers in exchange for the restricted marketing of their sugar, produced under onerous conditions required by the federal statute, is a burden or interference with the exertion of national power represented by the Sugar Act of 1937; and, finally, that the application of this gross income tax to petitioner's proceeds from interstate commerce would result in an unconstitutional burden on said commerce.

Errors Relied Upon

1. The United States Court of Appeals for the First Circuit erred in holding that the Puerto Rican Victory Tax, fully applied to the conditional payments received by individual sugar growers and producers under the Sugar Act of 1937, does not burden interstate commerce.

2. The court further erred in holding that such application of the Puerto Rican tax to conditional payments does not prejudicially interfere with the system of quotas and conditional payments set up by Congress in the Sugar Act of 1937.

3. The court further erred in upholding the constitutionality of the Puerto Rican taxing act's discrimination against individuals and in favor of artificial persons.

Argument

Summary of Point I

"The Puerto Rican Victory Tax Act, by its terms and as construed by the Supreme Court of Puerto Rico, levies a 5% tax on gross income. Although the act allows certain limited deductions, as pointed out by the Court below, the same are inoperative in this particular application of the statute because the full tax is here being assessed on the total amount of the conditional payments received by petitioner, save for a small exemption in the sum of $15.05 per week. (R. 266) The conditional payments on which such tax is laid are part of the total proceeds of petitioner's sugar sold for direct shipment in interstate and foreign commerce. Consequently, the application of such gross income tax to appellant's proceeds from interstate commerce would result in an unconstitutional burden or interference with said commerce."

Point I

The taxing act lays a tax of 5% "upon the gross income of every individual" in excess of a minimum amount ($15.05) per week. (R. 297) It, therefore, literally taxes gross income. And the Supreme Court of Puerto Rico has so construed the act: *Buscaglia* v. *Tax Court*, 69 P. R. Rep. 93, 105-106. Consequently, it hardly behooves the Court of Appeals below to hold, as it did (R. 304), that the exaction more closely resembles a net income tax. *De Castro* v. *Board of Commissioners*, 322 U. S. 451, 88 L. ed. 1384.

But the court below intimates further that in any event the Commerce Clause does not affect Puerto Rican legislation and that it "can have no consequential effect of

limiting territorial action" (R. 303) since Congress already has the power, under Article IV, Section 3, Clause 2 of the Constitution, to limit such action to any extent it chooses.

It is, of course, a well known constitutional doctrine that the Commerce Clause does not *ex proprio vigore* extend to the territories. But the emphasis lies in the phrase "*ex proprio vigore.*" " . . . the Constitution does not, *without legislation and of its own force,* carry such right to territory so situated."; *Dorr* v. *United States,* 195 U. S. 138, 49 L. ed. 128. See also *Hooven & Allison Co.* v. *Evatt,* 324 U. S. 652, 674, 89 L. ed. 1253, 1268. In other words, in the absence of legislation the Commerce Clause is applicable only to States and hence it does not automatically bar territorial legislation which might otherwise fall under its ban.

But Congress may extend the clause to apply to territorial legislation. It may, under the "needful rules and regulations" clause of the Constitution (Art. IV, Sec. 3, Cl. 2) limit territorial action to any extent it chooses. *Buscaglia* v. *Ballester Hermanos,* 162 F. (2d) 805, 807; *Sancho* v. *Bacardi Corporation of America,* 109 F. (2d) 57, 62.

In the particular field with which we are now concerned, —regulation of the marketing of sugar in interstate and foreign commerce,—Congress has extended the Commerce Clause's "secondary effect of a restriction upon the power of the States" [3] to Puerto Rico. The Sugar Act is a measure "to regulate commerce among the several States, *with the Territories and possessions of the United States,* and with foreign countries . . ." 50 Stat. 903. (Italics added.) The approval of this statute and its express application to Puerto Rico (See 50 Stat. 912), determined by Congress, operates as an extension to Puerto Rico of the implied prohibitions of the Commerce Clause. Therefore, at least in the field of sugar production and commerce, Puerto Rico

[3] *Buscaglia* v. *Ballester Hermanos, supra,* at page 807.

is no more at liberty to enact laws obstructing or burdening interstate commerce than are the forty-eight states of the Union. It certainly would be inconceivable that, in the face of a Congressional enactment regulating sugar commerce among the States, Territories and Possessions, the latter should be free to pass any local laws burdening or impeding such commerce.

Petitioner's position is, thus, that while the Commerce Clause does not *of itself* extend to Puerto Rico, its prohibitions have been extended to this territory by virtue of the approval by Congress of the Sugar Act of 1937, a measure enacted under the powers reserved to Congress by the Commerce Clause and made expressly applicable to Puerto Rico under the power of Congress to make all needful rules and regulations respecting the territories.

The question now before this Court is, thus, whether Puerto Rico may validly levy an unapportioned gross income tax on the proceeds of sales of sugar grown and produced by petitioner to be sold for immediate and direct shipment in interstate and foreign commerce.

The economic background of the Sugar Act clearly shows that Congress intended it to be primarily a measure to stabilize the sugar industry.[4] Such objective is effectuated through the establishment of quotas and the provisions for making conditional payments to producers. And inasmuch as an essential purpose of the declared policy of the Act is to restore the purchasing power of farmers to a parity level with other producers (7 U. S. C. A. 602), it would seem quite clear that the payments therein provided for constitute in substance and effect an additional price paid for the sugar produced. Indeed, such was the official interpretation; Plaintiff's Exhibit 24, admitted at R. 82.

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[4] See "The Sugar Act of 1937", 47 Yale Law Journal 980.

Further, the relevant statutory provisions point to these payments as effective additions to the price paid to producers for their product. No payment can be made unless the producer markets his sugar; Section 301c. The payments are computed on sugar, raw value; Section 304. And raw value is defined in terms of the recognized standard used to fix the commercial price of sugar in the market, namely 96 sugar degrees by the polariscope; Section 101h.

Practical considerations are also indicative of the effect of these payments. In return for the sugar produced and marketed, the producer actually gets the basic minimum contractual price *plus* the amount of the conditional payments. The conditions upon which the payments are made (Child labor prohibition, payment of prescribed wages, crop restriction, and certain farming practices), ineludibly imply added production costs, later recovered through receipt of the payments which, accordingly, are an effective and substantial part of the returns obtained by the producer from the sale of his sugar.

It is elementary that a state can neither lay a tax on the act of engaging in interstate commerce, *nor on gross receipts therefrom. East Ohio Gas Co.* v. *Tax Commission,* 283 U. S. 465, 75 L. ed. 1171. Such tax operates to lay a direct burden upon every sale in commerce by withholding for the use of the state a part of every dollar received from such sale. *Crew Levick Co.* v. *Pennsylvania,* 245 U. S. 292, 62 L. ed. 295. In the present attempted application of the Victory Tax, Puerto Rico is seeking to lay a gross income tax on an amount of money which petitioner received from the Secretary of Agriculture in return for his marketing of sugar in interstate commerce, a sale made under the provisions of a federal statute enacted as a regulation of commerce among the states and territories. Of course, a state may tax the money actually within its jurisdiction after it

has passed the stage of compensation or proceeds of a sale, but it does not follow that it may validly levy a gross income tax on the proceeds of these sales. *Fargo* v. *Stevens,* 121 U. S. 230, 30 L. ed. 888; *Cook* v. *Pennsylvania,* 97 U. S. 566, 24 L. ed. 1015.

Needless to say, the indication of the court below to the effect that "subsidies somewhat like these payments were properly taxable under the federal tax law" (R. 304) completely misses the point relative to the constitutional prohibition of *state taxes* which directly burden interstate commerce. Further, that indication fails to notice that the tax here involved is one on gross income while the federal income tax law levies a tax on net income.

Perhaps it should now be stressed that we are dealing with a gross income tax, which, in contrast with ordinary net income taxes, tends to place a proportionately heavier burden upon individuals who suffer losses or have a low ratio of net to gross earnings. Although net income taxes do not burden interstate commerce in a non-permissible way, *Cf. Western Live Stock* v. *Bureau of Revenue,* 303 U. S. 250, 82 L. ed. 823, certainly local taxes measured by gross receipts from interstate commerce have quite consistently been pronounced unconstitutional. *Gwin, White & Prince* v. *Henneford,* 305 U. S. 434, 83 L. ed. 272; *Matson Navigation Co.* v. *State Board of Equalization,* 297 U. S. 441, 80 L. ed. 791; *Fisher's Blend Station* v. *Tax Commission,* 297 U. S. 650, 80 L. ed. 956. And the mere fact that the local levy does not discriminate against interstate commerce, or in actuality or by possibility subject it to the cumulative burden of multiple exactions, does not show that such tax is valid, nor that it does not unconstitutionally burden or obstruct interstate commerce. *Joseph* v. *Carter & Weekes S. Co.,* 330 U. S. 422, 91 L. ed. 993. It may not be amiss to note here that petitioner is liable also for the general income

and ad valorem taxes of Puerto Rico, and, thus, that the present exaction is not in lieu of any other taxes. As a matter of fact, in this particular attempted application of the taxing act, Puerto Rico seeks to impose the tribute *exclusively* on that income which was received by petitioner as a consequence of producing, selling, and marketing sugar in interstate commerce in compliance with all the conditions prescribed in a federal enactment.

The all-important difference between a gross receipts tax and one measured by net income, from the standpoint of their effect on interstate commerce, was early adverted to by this Court:—*United States Glue Co.* v. *Oak Creek,* 247 U. S. 323, 62 L. ed. 1135. Such difference affords a convenient and workable basis of distinction between a direct and immediate burden upon the business affected and a charge that is only indirect and incidental.

For the purposes of the present discussion the fact that the court below described this tax as more closely resembling a net income tax can have no material significance because such characterization is plainly erroneous, inasmuch as the Victory Tax is a gross income tax. We are not, however, concerned here with descriptive labels. Whether the particular application of the tax enactment here attempted violates the commerce clause depends not upon labels, but upon the incidence of the tax, *Spector Motor Service* v. *O'Connor,* 95 L. ed. (Adv. Op.) 435, and the tax is here sought to be laid exclusively upon payments received by petitioner as part of the proceeds of sugar produced for, and sold in, interstate commerce. Accordingly, the tax in this specific instance incides directly into petitioner's gross receipts from interstate commerce. *Freeman* v. *Hewitt,* 329 U. S. 249, 91 L. ed. 265.

In disposing of this point, the court below seems to have been heavily influenced by the consideration that Congress,

although having the power to do so, "has not acted to annul the Victory Tax Act nor has Congress prohibited the Act's taxation of the conditional payments under the Sugar Act." (R. 304.) Such circumstance, of course, can have no compelling significance. Congress has *never* exercised its power to annul Puerto Rican statutes. Yet many insular enactments have been declared unconstitutional, even by the court below itself. For a recent example, see *Rivera* v. *R. Cobian Chinea & Co.*, 181 F. (2d) 974 (1950). Furthermore, this Court once admonished that "To justify the conclusion that Congress has consented to the violation of one of its own acts of such fundamental character, will require something more than such inaction upon its part as really amounts to nothing more than a failure affirmatively to declare such a violation by a formal act." *Springer* v. *Philippine Islands*, 277 U. S. 189, 72 L. ed. 845, 852.

It is, therefore, respectfuly submitted that this specific application of the Puerto Rican 5% gross income tax to conditional payments received by petitioner as part of the total proceeds from the sales of his sugar for direct shipment in interstate commerce, pursuant to the provisions of the Sugar Act of 1937, is invalid as a non-permissible restraint or burden on such commerce.

Summary of Point II

"The Congress of the United States is empowered by the Constitution to regulate commerce with foreign nations and among the several states. That authorization and the laws enacted pursuant thereto are supreme, and, in case of conflict, they control state and territorial enactments. The states and territories may not burden or interfere with the exertion of national power or make it a source of revenue. The Sugar Act of 1937 embodies a Congressional scheme of regulation having as its primary objective the stablization of the sugar producing, refining and importing industries. This

over-all objective is effectuated through the establishment and use of quotas under which the United States market is divided among the various domestic sugar-producing areas and certain foreign sugar-producing areas. As a means of implementing the sugar quotas authorized to be established, provision is made for making payments to domestic producers. Conditional payments are, thus, no different in their principle from a tariff applied to imports. Both constitute a Federal method of fostering interstate and foreign commerce and preventing ruinous competition in it. Consequently, a gross income tax on the total amount of said payments operates to actually withhold for the use of Puerto Rico a part of every dollar allotted by Congress to sugar producers in exchange for the restricted marketing of sugar produced under specific conditions enumerated by the federal statute, and, in substance and effect, is a burden or intereference with the exertion of national power represented by the Sugar Act."

Point II

In sustaining the validity of the Agricultural Adjustment Act of 1938, this Court pointed out that one of the primary purposes of that act was to increase the market price of the commodities regulated and to that end to limit the volume thereof that could affect the market. *Wickard* v. *Filburn*, 317 U. S. 111, 87 L. ed. 122, 137. Similarly, in upholding the quota provisions of the Sugar Act of 1937, the Court of Appeals for the District of Columbia adverted to the fact that "the very foundation stone of the Sugar Act is the prohibition or restriction of otherwise legitimate economic activity,—the marketing of sugar beyond the amount of the quota." *Gay Union Corporation* v. *Wallace*, 112 F. (2d) 192, cert. den. 310 U. S. 647, 84 L. ed. 1414.

Under Title III of the Act, payments are authorized to be made on several conditions. Since the main objective of the statute is to stabilize the sugar industry by limiting the

volume thereof that could affect the domestic sugar market, one of the essential conditions calls for a restriction of the amount of sugar marketed in interstate commerce by each producer. (Section 301c.) Other conditions require payments of the particular wages determined by the Secretary of Agriculture, proscription of child labor, and specific farming practices for improving the fertility of the soil and preventing erosion. All of them imply added expenses and, of course, higher production costs. The payments subsequently made are intended to actually raise the effective price of the product and thereby to compensate for the additional expenses incurred in meeting the conditions demanded.

Thus, the conditional payments, as well as the quota system, set up in the statute are the two controlling media or instruments devised to carry into effect the declared policy of Congress as to the orderly marketing of sugar in interstate commerce. The payments are, as much as the quotas, a vital integrant part of the statutory method designed by Congress to procure the stabilization of the flow of sugar in interstate and foreign commerce. Such, at least, was the legislative intention:—

> "Conditional payments are no different in principle from a tariff applied to imports. Both constitute a Federal method of fostering interstate and foreign commerce and preventing ruinous competition in it. If the sugar producer receives a reasonable return for his commodity, the market is stabilized, and if coupled with that, the consumer is not subjected to undue or additional burdens, the conditional payment is a fair price to pay for the results to the whole population of a sugar program."[5]

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[5] House Report No. 1179, 75th Congress, First Session, Legislative Report of July 2, 1937.

But, although Congress specifically prescribed a precise base rate of 80 cents per hundred pounds for the payments to producers who comply with the conditions imposed, Puerto Rico is here seeking to validate an application of its 5% gross income tax which would cut the base rate to 76 cents per hundred pounds. Thereby, this particular "Federal method of fostering interstate and foreign commerce and preventing ruinous competition in it" is being interfered with, or burdened, to the extent at least of depriving producers of what Congress intended should be their full and exact compensation.

Consistently with the Federal Constitution, a State may not tax the operations of an instrument employed by the government of the Union to carry its constitutional powers into operation. That principle, while not expressly stated in the Constitution, necessarily arises out of our dual government. It has often been given effect. Its application does not depend upon the amount of the exaction, the weight of the burden, or the extent of the resulting interference with sovereign independence. Where it applies, the principle is an absolute one wholly unaffected by matters or distinctions of degree. *Indian Motorcycle Co.* v. *United States,* 283 U. S. 570, 575, 75 L.ed. 1277, 1281, and cases cited therein. *Cf. Williams* v. *Talladega,* 226 U. S. 404, 57 L.ed. 275.

Petitioner fully realizes the recent restrictions of the concept "agency or instrumentality of the Federal government." Nevertheless, it is quite clear that the conditional payments, or rather the amounts received by sugar producers pursuant to the provisions of the Sugar Act, are not quite classifiable within the same tax base category as income received by individuals or firms furnishing supplies or rendering services to the United States. Certainly in these latter cases no particular statutory means or methods

are involved; no onerous conditions are to be previously complied with; no stabilization of any industry affecting interstate commerce is concerned; no legislatively devised method to foster commerce and avoid ruinous competition in it is at stake. The difference is illustrated by cases like *Kennecott Copper Corporation* v. *State Tax Commission*, 60 F.Supp. 181,[6] where the court held that certain subsidies for war production paid to a mining company by the United States, pursuant to an order of the Office of Price Administration, could not validly be included in the tax base used by the local tax commission to compute a state occupation tax of 1% of the gross amounts received by the company for ore sold. The claim made there was that the inclusion of the subsidy in the tax base interfered with the war powers of Congress and the Emergency Price Control Act by taxing the subsidy on surplus production over fixed quotas "with the result that a part of the subsidy was diverted from its sole purpose of insuring the maximum necessary production." (90 L. ed. at page 865.)

In the case at bar, the tax is sought to be laid directly and exclusively on the full amount of the conditional payments, with the obvious result that a part of the payments is thereby diverted from its sole purpose of insuring the orderly flow of sugar into the national market. Needless to say, if a state may not legitimately lay a tax of this nature, *a fortiori* a territory or insular possession of the United States is certainly in no better position to exercise that power. *Domenech* v. *National City Bank*, 294 U. S. 199, 79 L. ed. 857.

Summary of Point III

"The Puerto Rican Victory Tax Act, here attempted to be applied to conditional payments, violates the

[6] Reversed on jurisdictional grounds in *State Tax Commission* v. *Kennecott Copper Corporation*, 150 F. (2d) 905, certiorari granted 326 U.S. 711, affirmed 327 U.S. 573, 90 L.ed. 862.

equal protection clause of the Fourteenth Amendment and of Section 2, paragraph 1, of the Organic Act for Puerto Rico, insofar as said taxing enactment levies a 5% gross income tax on conditional payments received by individual sugar growers and producers while failing to levy the tax on conditional payments received by partnerships, corporations, successions, trusts, undivided joint owners, etc., and other artificial persons engaged in the same activity, namely, the cultivation of sugar cane and the production of sugar, under exactly the same conditions and circumstances. Such classification is arbitrary and not reasonably related to the objects of a statute designed to raise revenue."

Point III

The tax here involved is applicable only to individuals, defined in the act as natural persons.[7] Neither corporations, partnerships, successions, nor undivided joint owners ("comunidades")[8] are subject to the exaction. The record shows that there is a large number of such artificial entities in Puerto Rico engaged in the production, processing, and sale of sugar, and consequently receiving conditional payments under the Sugar Act. (R. 64-66.) The local tax is one that can be laid upon receipts belonging to corporations, partnerships, or other artificial persons quite as conveniently as upon those of natural persons, since it is primarily a revenue measure. It is not peculiarly applicable to individuals only.

Accordingly, we have a situation where the individual is compelled to pay the tax upon conditional payments he receives from the production and marketing of sugar, while corporations, partnerships, and other artificial entities producing and marketing sugar under the same circum-

[7] See Section 1 of the Act, Appendix.

[8] Civil Code of Puerto Rico, 1930 ed., Sections 326-340.

stances and conditions escape entirely from this tax, even though they receive conditional payments from the same source, computed at the same rates and by the same methods, and paid upon compliance with the same conditions.

It has frequently been decided that absolute equality in taxation cannot be obtained and is not required under the Fourteenth Amendment. *Colgate* v. *Harvey,* 296 U. S. 404, 80 L. ed. 299, and cases cited therein. This, of course, is not to say that, because some degree of inequality from the nature of things must be permitted, gross inequality must also be allowed. The boundary between what is permissible and what is forbidden has never been precisely fixed and is incapable of exact delimitation. Generally, the states are not precluded from resorting to classification for the purposes of legislation, and the power of the states to classify is of wide range and flexibility. *Louisville Gas & Electric Co.* v. *Coleman,* 277 U. S. 32, 37, 72 L. ed. 770, 774.

But the classification must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the objects of the legislation, so that all persons similarly circumstanced shall be treated alike. *Royster Guano Co.* v. *Virginia,* 253 U. S. 412, 64 L. ed. 989. The classification, in order to avoid the constitutional prohibition, must be founded upon pertinent and real differences, as distinguished from irrelevant and artificial ones. "Mere difference is not enough . . .", this Court has said. *Louisville Gas & Electric Co.* v. *Coleman,* supra.

The test to be applied is — does the statute arbitrarily and without genuine reason impose a burden upon one group of taxpayers (*here, the natural persons receiving conditional payments*) from which it exempts another group (*artificial entities receiving conditional payments*), both

groups occupying substantially the same relation toward the subject matter of the legislation?

Petitioner respectfully submits that the test is not here satisfactorily met. The statute itself suggests no public purpose which will be served by the exemption of artificial persons. So far as this question is concerned, the classification thus made bears no substantial or fair relation to the object of the act, which is simply to secure revenue. Petitioner has been unable to find in the statute any public purpose which can be subserved by making the taxation of income from conditional payments dependent merely upon the adventitious circumstance as to the business organization of the recipient of the payments. If there be circumstances which will justify such exemption, it is for the Legislature to point them out. To import any such circumstances into the present situation is to indulge in pure speculation. *Cf. Travis* v. *Yale & Towne Mfg. Co.*, 252 U. S. 60, 81, 64 L. ed. 460, 470. As this Court indicated in a comparable occasion:

> "To assume that some unnamed public interest exists, which will sustain the discrimination, does not help the matter here; because the assumption can rest only upon surmise, with nothing concrete or explicit appearing to support it or to indicate a legislative intent to relate the exemption to any public purpose or to anything else beyond the mere fact that the favored loans are effected within the state."[9]

This question has been squarely adjudicated by this Court and by state courts of last resort in several cases. In *Quaker City Cab Co.* v. *Pennsylvania*, 277 U. S. 398, 72 L. ed. 927, this Court held that the imposition of a tax on the gross receipts of corporations operating taxicabs, when it is not imposed upon individuals and partnerships engaged

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[9] *Colgate* v. *Harvery, supra,* 296 U.S. at page 425.

in the same business, unconstitutionally deprives corporations of the equal protection of the laws. The following language, from the opinion written by Mr. Justice Butler, is quite apposite:

> "In effect Section 23 divides those operating taxicabs into two classes. The gross receipts of incorporated operators are taxed while those of natural persons and partnerships carrying on the same business are not. The character of the owner is the sole fact on which the distinction and discrimination are made to depend. The tax is imposed merely because the owner is a corporation. The discrimination is not justified by any difference in the source of the receipts or in the situation or character of the property employed. It follows that the section fails to meet the requirement that a classification to be consistent with the equal protection clause must be based on a real and substantial difference having reasonable relation to the subject of the legislation . . . *No decision of this court gives support to such a classification. In no view can it be held to have more than an arbitrary basis.*"

The converse of the proposition has also been approved by this Court. In *Frost* v. *Corporation Commission,* 278 U. S. 515, 73 L. ed. 483, it held that an individual owner of a cotton gin who cannot do business without a franchise based on public necessity is unconstitutionally deprived of the equal protection of the laws by a statute permitting the securing of a franchise without such necessity by corporations. This Court remarked pointedly that: "A classification which is bad because it arbitrarily favors the individual as against the corporation cannot be good when it favors the corporation as against the individual." (278 U. S. 522.)

A tax similar to that questioned here was involved in the leading case of *Redfield* v. *Fisher,* 292 Pac. 813, 73 ALR 721 (cert. den. sub nom. *Fisher* v. *Redfield,* 284 U. S. 617, 76

L. ed. 526) where the court held that the equal protection of the laws is denied by a statute imposing upon individuals an annual tax of 5% upon gross income from intangibles, where corporations are not similarly taxed. It may, incidentally, be noted that the act invalidated by the above decision granted an exemption of $200 in computing the amount of income subject to tax. The Puerto Rican act taxes gross income of individuals over and above $15.05 per week.

In disposing of this point, the court below simply stated that "the classification is not unreasonable" (R. 305); that the distinction between individuals and artificial persons or associations is not unusual in the federal tax structure; and that "it is conceivable" (R. 305) that the insular legislature considered this tax as an anti-inflation device during the war period.

Such assumption, however, does not help the matter here, because it can rest only upon surmise, with nothing concrete or explicit appearing to support it or to indicate a legislative intent to relate the exemption of artificial persons to any public purpose. No doubt, inventiveness or ingenuity might possibly supply other "conceivable" bases upon which to support a pretended justification of the act's discrimination, but certainly such would be extremely weak and fanciful support pillars for an otherwise invidious classification.

The assumption that the insular legislature may have considered this taxing act as an anti-inflation device can hardly account for the discrimination. The act is made inapplicable not only to corporations but also to partnerships, successions, joint ventures, trusts, and all other artificial persons not organized in corporate form. These artificial persons, although not individuals, are food consumers in Puerto Rico. They purchase large quantities

of staple food products. Further, inflation is not limited to the field of food purchases. It presumably covers all necessary things in life. And, of course, artificial entities do purchase large quantities of items other than food products. Moreover, the act is also made applicable to nonresidents, and it is hard to understand how a tax on nonresidents can help curb local inflation. In any event, the argument that an overt tax discrimination may be justified on the ground that the statute represents a permissible legislative attempt to curb inflation through a reduction of purchasing power and standards of living, would be an easy way of sustaining almost every tax that would otherwise fall under the ban of the constitutional prohibition against arbitrary and invidious classifications.

In reality, therefore, stripped of immaterial distinctions and reduced to its ultimate effect, the statute here involved "baldly creates one rule for a natural person and a different and contrary rule for an artificial person, notwithstanding the fact that both are doing the same business . . ." *Frost* v. *Corporation Commission,* 73 L. ed. at page 489.

Accordingly, it is respectfully submitted that such classification is arbitrary because based upon no real or substantial difference having reasonable relation to the subject dealt with by the legislation.

Conclusion

The decision of the Court of Appeals, in sustaining the validity of the Puerto Rican statute's tax discrimination, deprives petitioner and all the individual growers and producers of sugar in Puerto Rico of the equal protection of the laws. It is a decision of a federal question in a way obviously in conflict with applicable decisions of this Court.

Furthermore, so far as petitioner is informed, this case presents for the first time the question as to whether a

territorial legislature may enact laws burdening or interfering with the foreign and interstate commerce in sugar as regulated by the Sugar Act of 1937. From the lower court's opinion a clear inference may be gathered that, in the absence of an affirmative act of disapproval by Congress and because of the inapplicability of the Commerce Clause to territories, the latter are free to legislate along these lines. Such holding, petitioner submits, is wrong.

This case further involves important questions concerning the administration and operation of the Sugar Act provisions relative to conditional payments, and the power of states and territories to tax said conditional payments, which have not been, but should be, settled by this Court.

Respectfully submitted,

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DARK PAGE BLEED THRU

APPENDIX

"An Act to Provide Revenues for the People of Puerto Rico Through the Levying of a Certain Additional Income Tax Which Shall be Known as 'The Victory Tax'; to Appropriate Funds for the Administration of this Act, and for Other Purposes", approved December 7, 1942 and amended May 10, 1943 and May 15, 1943. (Laws of Puerto Rico, 1943, pages 146 and 630 respectively.)

"Section 1. A tax of five (5) per cent on the gross income of every individual, in excess of fifteen dollars and five cents ($15.05) a week, for interest, rents, salaries, wages, day wages, fees, donations, compensations, remunerations, commissions, premiums, dividends, benefits in partnerships, whether civil or commercial, annuities, and any other income of whatever nature that is in cash, is determinable, and is not obtained from transactions in connection with contracts of purchase and sale in which those who receive it may have acted as contracting parties, or from reimbursements, returns of deposits, liquidations, inheritances, loans, payments on loans, and other similar operations, is hereby levied, and shall be collected and paid, in addition to any other tax levied by the Income Tax Act of 1924, and up to six months after the cessation of hostilities between the United States of America and Germany, Italy and Japan. Without this being subject to interpretation as a limitation of the terms 'salaries', 'wages' and 'day wages', the same refer also to every kind of salaries, wages and day wages paid in Puerto Rico by the Government of the United States of America. In the case of rents, there shall be deducted also as an exemption any amount actually paid as interest for liens on the property producing rent. Of the income subject to taxation by this Act there shall be deducted also as exemptions, the amounts received as compensation for labor accidents; scholarships; the sums paid by the taxpayer during the taxable year for premiums on his life insurance policies, or on the life insurance policies of his wife or children, and on insurance policies against acci-

dents, or for educational purposes, up to an aggregate insurance of twenty-five thousand ($25,000) dollars; the sums obtained or collected on life insurance policies, or on insurance policies against accidents or for educational purposes during the life of the insured, and the sums paid as compensation for cultural or artistic activities sponsored by the University of Puerto Rico or by any organization or association not for pecuniary profit. By gross income shall be understood every sum of money derived from the sources above enumerated as subject to taxation which is actually received by the taxpayer or deposited or assigned in his favor or for his benefit. The word 'payment' as used in this Act shall have also that same meaning . . ."

"The word 'individual' as used in this Act shall mean a natural person and shall include:— Residents of Puerto Rico, married or single, without application of the provisions of the Civil Code relative to conjugal partnership, and all natural persons residing or domiciled outside of Puerto Rico, whether or not citizens of the United States of America and of Puerto Rico, if these persons receive or are to receive income from any one or more sources listed as taxable under this Act, and said income is derived from causes established in Puerto Rico and the source of payment is located in Puerto Rico."

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DARK PAGE BLEED THRU

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1951

No. 550

AUGUSTO R. SOLTERO,

Petitioner,

vs.

SOL LUIS DESCARTES, TREASURER OF PUERTO RICO, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

RESPONDENT'S BRIEF OPPOSING PETITION FOR CERTIORARI

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Counsel for Respondents.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1951

No. 550

AUGUSTO R. SOLTERO,

Petitioner,

vs.

SOL LUIS DESCARTES, TREASURER OF PUERTO RICO, ET AL.,

Respondents

RESPONDENTS' BRIEF IN OPPOSITION

Opinions Below

The opinions of the Tax Court of Puerto Rico (R. 229-241, 248-249) and the opinions of the Supreme Court of Puerto Rico (R. 242-244, 263-267) are contained in the record in English translation. The first opinion of the Tax Court, of January 9, 1947, is reported in 5 D.T.C. 74, in Spanish. Neither opinion has been officially reported in English.

The opinion of the United States Court of Appeals for the First Circuit is reported in 192 F. (2d) 755. The opinion is also printed in full in the Record, pp. 296-305.

Jurisdiction

The judgment of the United States Court of Appeals for the First Circuit was entered on November 8, 1951 (R. 306).

The jurisdiction of this Court is invoked under Section 1254 (1) of the Judicial Code (28 U.S.C.A. 1254). The application is made pursuant to Rule 38, par. 5, subdivision (b) of the Rules of this Court, alleging that the Court of Appeals has in this case decided an important question of federal law which has not been, but should be, settled by this Court and, further, that the Court of Appeals has decided a federal question in a way probably in conflict with applicable decisions of this Court.

Statement of the Case

Since the statement of the case made by petitioner in his brief in support of petition for writ of certiorari (pp. 10-14) has some inaccuracies and omissions the corrections of which respondent considers material to the consideration of the questions presented, the respondent prefers to make his own statement, although following on general lines the order of presentation made by petitioner.

During the years 1942 to 1945 the petitioner, a farmer, cattle owner, accountant, and lawyer (R. 16, 30), grew sugar cane which was ground into sugar at Central Victoria, a sugar mill in Carolina, Puerto Rico, under an agreement whereby the mill got thirty-five per cent of the sugar so obtained and petitioner the remaining sixty-five per cent (R. 38, 47). Petitioner's portion of the sugar was left at the mill with instructions that it be sold for him (R. 17, 18, 37). The sugar was sold by the sugar mill to the Commodity Credit Corporation, a corporate agency of the United States (R. 50), in accordance with purchase contracts providing for the sale of sugar processed by the mill on yearly crop bases (Exhibits 14-16, R. 122-188, admitted at R. 28). Once these contracts were finally liquidated and settled, the mill notified petitioner with a statement showing in detail the amount of money due him for this share of the sugar sold to

Commodity (R. 54 and Exhibit 20, R. 191). This money was paid directly to him by checks of the sugar mill (R. 38, 55). In addition to the above liquidated proceeds from the sugar sold, and in compliance with the purchase contracts, petitioner received, again by checks of the sugar mill, a subsidy from the United States through the Commodity Credit Corporation. The sugar mill participated in this subsidy with the petitioner and even petitioner's portion had to be shared with his laborers (R. 45-46, 51, 168-169). This was all that petitioner received as a result of the sale of his sugar to the Commodity Credit Corporation through Central Victoria.

The additional money received by petitioner was in the form of "conditional payments," in conformity with Title III of the federal Sugar Act of 1937 as amended.[1] These payments were received by petitioner during the period from January 1, 1943 to May 15, 1945,[2] after due compliance with the several conditions established in Title III of the Sugar Act (R. 39-40) and upon applications and certifications crediting the compliance of such conditions and giving other necessary data (Plaintiff's Exhibit 1-3, admitted at R. 18-20; 88-95). The payments amounted to $881.17 for 1942, $1,389.45 for 1943, and $1,224.72 for 1944 (R. 87, 94, 95), and were paid by checks from the Treasurer of the United States (R. 40-41, 87).

In his statement of the case (Brief p. 10) petitioner expresses that:

> Inasmuch as all the sugar thus produced during the years 1943-45 was sold to Commodity in conformity with the provisions of the Sugar Act of 1937 (7 U. S. C. A. 1100 et seq.), petitioner received the basic contractual price plus the conditional payments provided

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[1] 50 Stat. 909-912, as amended December 26, 1941, 55 Stat. 872-873.

[2] Period of operation of the Victory Tax Act. See footnote 4, *infra*.

> for in said statute. Accordingly, during those years petitioner was paid not only the contractual basic minimum price of $3.46 per hundred pounds, but also the further sum of 80 cents per hundred pounds of sugar marketed.

This statement of petitioner is misleading and inaccurate in three ways. (1) It gives the impression that the sugar produced by petitioner was sold to Commodity pursuant to and in compliance with the Sugar Act. Yet this is not correct because said act does not require that the sugar be sold to Commodity (R. 72). (2) It suggests that it was Commodity which, in addition to the price paid for petitioner's sugar, made the conditional payments. It is clear, and the record shows, that said payments were made by the United States Treasury Department (R. 40, 41, 87). (3) It makes the incomplete assertion that petitioner was paid for his sugar not only the contractual price of $3.46 per hundred pounds but also the further sum of 80 cents per hundred pounds of sugar marketed, when the record shows that petitioner was also paid that sum of 80 cents for certain sugar which was neither marketed nor even produced.[3]

During the period of January 1, 1943 to May 15, 1945 there was a statute in force in Puerto Rico which levied a 5% upon certain income—which is described as gross income—of every individual on the Island.[4] This statute was repealed on May 15, 1945 (Laws P. R. 1945, p. 1265).

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[3] Plaintiff's Exhibit 1, R. 89, admitted at R. 18, reveals that although the petitioner actually produced, during the 1943-44 crop year, 1170.64 hundred pounds of sugar (item 1), he was nevertheless paid for 1530.90 hundred pounds (items 11, 12), thus receiving conditional payments for 360.26 hundred pounds of sugar which he did not produce (item 10).

[4] This tax was denominated "the Victory Tax." It was originally enacted on December 7, 1942, and subsequently amended on May 10 and May 15, 1943. (Laws P. R. 1942, 3rd. Sp. Session, p. 160; Laws P. R. 1943, pp. 146 and 630). The relevant sections of the Act are set out in the appendix hereto.

The petitioner did not include in his tax returns filed for those years, under the Victory Tax Act,[5] the conditional payments received by him (R. 44, 83-84, 228-229). The insular treasurer, after giving him opportunity to file additional returns and pay the corresponding tax, which he refused to do, consequently assessed tax deficiencies on the conditional payments. It is convenient to emphasize at this moment that no 5% Victory Tax was assessed on nor paid by petitioner on the proceeds from the sale of his sugar to Commodity, nor on the subsidy paid to him by that corporation (R. 83, 229).

Another misstatement of petitioner should be corrected at this moment. He states that "during all the time the act was in force, the Treasurer did not construe it as applicable to the conditional payments authorized by the Sugar Act" and that "accordingly, no attempt was made during that time to levy or collect the tax on said payments" (Br. 11). It is correct that it was not until four months after the repeal of the Act that petitioner was directed to pay the tax on the conditional payments, but it does not follow from this that the Treasurer considered the statute inapplicable to said payments until then. As a matter of fact, there has never been any official administrative interpretation from the Insular Treasury Department so establishing, nor even has there been any consultation by any taxpayer to the Treasurer to that effect. The record does not warrant the existence of such a ruling or consultation, and the portion of the record (R. 84) from where the petitioner purports to obtain the above assertion explains, through the testimony of Mr. Carlos A. Monagas, that the reason why no steps were taken to collect the tax from the farmers until the Act was repealed was that "at first we had few personnel and the payments were made every six months." "We

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[5] Sections 4 and 7 of the Victory Tax Act, *supra*.

received around 25,000 returns and we spent most of the time liquidating and checking them and we had no time to do anything else" (R. 84). The witness further testified that the Victory Tax Bureau had notified other deficiencies to other farmers and that as a matter of fact there had been many returns voluntarily filed by other farmers (R. 84).

The petitioner, disagreeing with the imposition of the tax on the conditional payments, commenced proceedings before the Tax Court of Puerto Rico. In his complaint he attacked the imposition of the tax on the following grounds: (1) the Act was totally repealed and consequently the Treasurer had no authority to determine any tax pending payments, (2) the saving clause contained in Section 2 of the repealing act was void because the matter to which it referred was not clearly expressed in the title of said Act, (3) the saving clause referred to above, if valid, referred exclusively to taxes already liquidated, and therefore owed, while the Victory Tax was in effect, (4) the Victory Tax Act was void because it violated the uniformity and equal protection clauses of the Organic Act and the Federal Constitution by imposing a tax exclusively on the individual or natural person, (5) the Victory Tax Act, if valid, exempted from its tax the conditional payments received by petitioner because they were derived from contracts of sale, (6) the liquidation of the tax was erroneous, and (7) the conditional payments represented a reimbursement of the increased price of petitioner's sugar and a reimbursement of expenses incurred by him in complying with the conditions imposed on him by the Government in order to receive said payments, this reimbursement being specifically exempted from the Victory Tax.[6]

There was no allegation in the complaint assailing the tax on the ground of undue interference with an agency

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[6] See paragraph 2 of Complaint, R. 2.

or instrumentality of the United States, nor was there any allegation in the sense that the tax violated the commerce clause of the Federal Constitution.

After a trial on the merits, the Tax Court entered judgment for petitioner (R. 241), on the authority of its previous decision in the case of *Teodulo Llamas Muñiz* v. *Tesorero,* 4 D. T. C. 841 (Spanish version). Said judgment was not founded on any of the points posed by petitioner in his complaint, but on a novel theory not raised in the pleadings. The rationale of its decision was that the conditional payments could not constitute *the net incomes of special nature enumerated by the Victory Tax Act* because said payments represented, if not totally, at least in part, a reimbursement of expenses in addition to those which petitioner used to make in his business of planting, cultivating, and harvesting sugar cane (R. 240-241). In so holding the Tax Court simply followed its previous decision in the *Llamas* case, *supra,* where it held that the Victory Tax was in no case levied upon returns of capital investments, nor upon gross receipts *per se,* but upon net amounts of the gross incomes specified in the act. The Court distinguished between gross incomes that comprise *reimbursements* of expenses incurred in order to obtain said incomes and the net incomes of special nature enumerated in the Victory Tax Act, which according to the Court did not comprise *reimbursements* of expenses of any sort. The Court considered the act inapplicable to the former.

As the decision in the *Llamas* case was reversed by the Supreme Court of Puerto Rico,[7] on the ground that the Tax Court committed error in not considering the phrase "and any other income of whatever nature", found in Section 1 of the Victory Tax Act, the support for the decision in the instant case fell, and upon review, the judgment was vacated

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[7] *Buscaglia* v. *Tax Court,* 69 P.R.R. 93.

by the Supreme Court. The case was remanded to the Tax Court with instructions "to decide in the first instance, specifically and definitely, and not generally, why the conditional payments . . . constitute, *under Section 1 of the Victory Tax Act*, a reimbursement, if not totally, at least in part, of the expenses incurred . . . by reason of the Sugar Act of 1937."[8] (Italics supplied.) Additional instructions enjoined the Tax Court to decide, if necessary, the other questions raised by petitioner "such as if the said payments are derived from a contract of sale; whether the Victory Tax is void, for unconstitutionality, as applied to payments authorized by a federal statute;[9] and whether

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[8] The reason for this instruction was the fact that Section 1 of the Victory Tax Act exempted from its effects income obtained "from reimbursements." (See Appendix, *infra.*) But the Tax Court, in its opinion, had used the term "reimbursement," not in the sense it was used in said Section 1, but just to distinguish certain type of gross incomes, which comprise *reimbursements* of expenses incurred in order to obtain said incomes, from what the court called "*net incomes of special nature* enumerated by the Victory Tax Act." The Tax Court considered the Act applicable only to the latter category of incomes, and the conditional payments, not falling within this latter category, were not, therefore, subject to the tax. It is clear that if the Tax Court had found the conditional payments to be income obtained from "reimbursements," in the sense this term is used in Section 1 of the Victory Tax Act, it would have automatically declared them tax exempt without having to resort to the theory of the *Llamas* case, *supra*, which the Supreme Court rejected. But the Tax Court did not do that, and this accounts for the specific instruction of the Supreme Court to consider the "reimbursement" problem *under Section 1 of the Act*. This explanation clears up, also, the inaccuracy of petitioner's statement (Brief, p. 12, first paragraph) in the sense that "since that statute (Victory Tax Act) specifically exempts all reimbursements, it (the Tax Court) entered judgment for plaintiff." (This was not the *ratio decidendi* of the opinion of the Tax Court.

[9] By this time there had been no formal presentation by petitioner of any constitutional question aside from the alleged violation of the equal protection clause of the Organic Act and the Federal Constitution, raised in Paragraph 2(d) of the complaint. (R.3-4) (See ante, page 6). The constitutional question the Supreme Court enjoins the Tax Court to decide—the Supreme Court had already decided in the *Llamas* case, *supra*, the question of the alleged violation of the equal protection clause—can only make reference to a feeble intimation, made by petitioner in his

the Treasurer was authorized to collect the tax after Act No. 175 of 1943 was repealed" (R. 244).

By order of August 19, 1948 and "in accordance with the judgment of the Supreme Court", the Tax Court set for a new hearing of the case on the session of Tuesday, October 19, 1948 (R. 245). This new hearing came to be held on December 15, 1948, when, by stipulation, the case was resubmitted to the Tax Court on the record of the first hearing (R. 246). That court dismissed the case because it lacked evidence to determine "what portion of the so-called conditional payments corresponds to the reimbursement of the additional cost incurred by the petitioner" (R. 248), but did not take into consideration the higher court's instruction to decide the other questions involved.

The Supreme Court of Puerto Rico granted certiorari, and finally affirmed the Tax Court's judgment (R. 263-267). In so doing it held that the evidence contained nothing enabling the court to determine what portion of the conditional payments constituted a reimbursement which would be exempted from the Victory Tax. It also ruled that the conditional payments received by the petitioner were not derived from a contract of sale and consequently were not entitled to exemption under the Victory Tax Act. As to the alleged invalid discrimination against individuals by failing to tax corporations and other artificial persons, the court held that there was no violation of the equal protec-

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brief as appellee in the first occasion that the case came before the Supreme Court, in the sense that the conditional payments were an essential part of a system of public administrative law institutions created by Congress to confront specially the agricultural crisis and generally the national economic depression. Petitioner there said that taxation of the conditional payments would be unconstitutional because it would obstruct and make ineffective the national public policy established by Congress in the Sugar Act of 1937. This intimation was diluted in an elaborate disquisition on economic theories around the federal agricultural legislation. Perhaps, the petitioner had in mind the known constitutional doctrine of the federal government's immunity from state and territorial taxation.

tion clause. Various other points, not material here, raised by petitioner, were disposed of against him by the court. A motion for reconsideration (R. 268-289) was subsequently denied[10] (R. 289).

Appeal was taken by petitioner to the United States Court of Appeals for the First Circuit (R. 290). The points raised on appeal were that (1) the application of the tax to the conditional payments is in conflict with the commerce clause of the Constitution and interferes with an instrumentality of the Federal government; (2) the Victory Tax violates the equal protection clauses of the Organic Act of Puerto Rico and the Fourteenth Amendment to the Constitution insofar as levied on individuals and not on corporations and other artificial persons; (3) assuming the validity of the tax, the conditional payments are a part of the consideration or price paid for sugar sold and, therefore, specifically exempt from taxes by the Act; (4) the conditional payments constitute a reimbursement of additional expenses incurred by sugar cane growers in complying with the requirements of the Sugar Act, and, therefore, specifically exempt from the tax by the Victory Tax Act (R. 293-295).

The United States Court of Appeals for the First Circuit affirmed the judgment of the Supreme Court of Puerto Rico, and as to the aforementioned questions raised, held respectively that: (1) a tax on net income is not a burden

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[10] The petitioner states (Brief, p. 13) that "the Supreme Court of Puerto Rico affirmed the Tax Court's judgment *without deciding itself the constitutional questions involved,*" but in doing justice to the Supreme Court it should be explained that the only constitutional question formally and consistently raised by petitioner from the very beginning of the proceedings—the alleged violation of the equal protection clause—was actually decided by the Supreme Court on the authority of *Buscaglia* v. *Tax Court,* 69 P.R.R. 93 (R. 265). The other constitutional questions posed before this Court were formally raised for the first time in the motion for reconsideration before the Supreme Court of Puerto Rico. See ante, footnote 9.

on interstate commerce, and the Victory Tax certainly is not a gross receipts tax which is generally stricken down as invalid, but it more closely resembles a net income tax; there is no clear and convincing evidence that the Victory Tax thwarts the Sugar Act of 1937 so as to defeat congressional policy; (2) the distinction between individuals and artificial entities is not unreasonable; (3) the interpretation of the Supreme Court of Puerto Rico to the effect that the conditional payments received by the petitioner were not derived from a contract of sale and consequently were not entitled to exemption under the Victory Tax Act is reasonable and justified; (4) the Supreme Court's findings to the effect that the evidence contained nothing enabling the court to determine what portion of the conditional payments constituted reimbursements specifically exempted from the Victory Tax were supported by the record and would be adopted by the court (R. 296-306).

In his petition to this Honorable Court for a writ of certiorari, petitioner does not challenge the aforementioned last two holdings of the Court of Appeals. He limits himself to the former two holdings, which he severs in three separate points or errors relied upon (Brief, pp. 14-15).

ARGUMENT

Summary of Point I

The Commerce Clause of the Constitution does not extend to Puerto Rico. Therefore, the Victory Tax imposed upon conditional payments cannot be a burden upon the interstate commerce. Actually the question to be raised is whether Congress in the exercise of its constitutional power under Article IV, Sec. 3, Cl. 2, of the Constitution, has seen fit to give the insular government power to impose the disputed tax or whether Congress has in any way prohibited its imposition. The sweeping and comprehensive power

granted by Congress to the insular government by the Organic Act includes the authority to impose the Victory Tax Act. Although Congress granted such an ample power, it reserved expressly the power to annul legislation enacted by the Legislature of Puerto Rico. If Congress did not annul the Victory Tax Act, or at least, did not limit its application by a provision in the Sugar Act, or otherwise, prohibiting taxation of the conditional payments, there is no ground for insisting that the Victory Tax is void because it interferes with interstate commerce.

Moreover, the Victory Tax is an additional income tax and not a gross receipt tax. Therefore, the cases that hold taxation on gross receipts from interstate commerce unconstitutional do not control here. The conditional payments received by petitioner are not gross receipts.

Since the conditional payments are not part of the purchase price of the sugar sold, they cannot constitute proceeds of sales in interstate commerce.

Point I

The Commerce Clause of the Constitution, unlike its effect on the power of State legislatures, does not restrict the power of the insular Legislature, for the Commerce Clause does not extend to Puerto Rico, which is not an incorporated territory. *Lugo* v. *Suazo,* 59 F. 2d 386, 390; *Sancho* v. *Bacardi Corporation of America,* 109 F. 2d 57, 62-63, reversed on other grounds, 311 U. S. 150; *Buscaglia* v. *Ballester Hermanos,* 162 F. 2d 805, certiorari denied 332 U. S. 816; *Dorr* v. *United States,* 195 U. S. 138. "The Commerce Clause gives Congress plenary power to regulate our foreign and interstate commerce and thus as a necessary consequence it has the secondary effect of a restriction upon the power of the states in the premises. It thus has two aspects, but in neither of them, either as a grant of federal

power or as a necessarily consequential limitation upon state power, does it affect Puerto Rico. In its aspects of a grant of power to the federal government it adds nothing to the comprehensive power given to Congress by the Constitution (Art. IV, Section 3, Cl. 2) to legislate with respect to national territory, and it can have no consequential effect of limiting territorial action since Congress already has the power under Art. IV, Section 3, Cl. 2 *supra*, to limit such action to any extent it chooses even to the extent of annulling local legislation." *Buscaglia* v. *Ballester Hermanos, supra.*

Hence, the risk of interference with interstate and foreign commerce by the independent state legislatures, which the commerce clause forestalls, need not be apprehended with respect to the dependent insular legislature.

Therefore, if the commerce clause does not affect Puerto Rico, the only question to consider is "whether Congress, in the exercise of its Constitutional power under Article IV, Section 3, Cl. 2, to 'make all needful Rules and Regulations' respecting the Territory of Puerto Rico, has seen fit to give the insular government power to impose the disputed tax", *Buscaglia* v. *Ballester Hermanos, supra*, or whether Congress has in any way prohibited its imposition.

In Section 32 of the Foraker Act (31 Stat. 77, 83, 84) and again in Section 37 of the Jones Act (39 Stat. 951, 964) Congress gave to the insular legislature the general power to legislate in language sweeping and comprehensive in character. *Buscaglia* v. *Ballester Hermanos, supra.* Thus, Section 37 of the Organic Act provides (Appendix, *infra*): "That the legislative authority herein provided shall extend to all matters of a legislative character not locally inapplicable . . ." Referring to this statute, this Court said, in *Puerto Rico* v. *Shell Co.*, 302 U. S. 253, 261:

> The grant of legislative power in respect of local matters, contained in § 32 of the Foraker Act and con-

tinued in force by § 37 of the Organic Act of 1917, is as broad and comprehensive as language could make it.

Further, Section 3 of the Organic Act confers on the insular government specific power to impose taxes by providing "That no export duties shall be levied or collected on exports from Puerto Rico, but taxes and assessments on property, internal revenues, and license fees, and royalties for franchises, privileges, and concessions may be imposed for the purposes of the insular and municipal governments, respectively, as may be provided and defined by the Legislature of Puerto Rico". This section was amended on March 4, 1927 by Section 1 of the Butler Act (44 Stat. 1418) and by this amendment the words "income taxes" were added after the phrase "taxes and assessments on property" in the first sentence of the Section. *Buscaglia* v. *Ballester Hermanos, supra.*

There should be no doubt that the insular government could impose the Victory Tax under this sweeping and comprehensive power granted by Congress.

Moreover, Section 34 of the Organic Act (Appendix), in declaring the extent of the power of Congress to limit Puerto Rican action under Art. IV, Sec. 3, Cl. 2 of the Constitution (Appendix), expressly reserves the power and authority to annul legislation enacted by the insular Legislature. To implement and expedite this power, said Section 34 provides that all laws enacted by the Legislature of Puerto Rico shall be reported to the Congress of the United States, and Section 23 (Appendix) provides "that the Governor of Puerto Rico, within sixty days after the end of each session of the Legislature, shall transmit to the executive department of the Government of the United States, to be designated as herein provided for, which shall in turn transmit the same to the Congress of the United States, copies of all laws enacted during the session." If Congress,

zealous as it has been in expressly reserving its power to annul, has not done so with the Victory Tax Act, or at least, has not limited its application by a provision in the Sugar Act, or otherwise, prohibiting taxation of the conditional payments, there is no ground for insisting that the Victory Tax is void because it interferes with interstate commerce. It is true, as petitioner says (Brief, p. 21), that Congress has never exercised its power to annul Puerto Rican statutes and that yet many insular enactments have been declared unconstitutional, even by the court below itself; but it is clear that this has only occurred whenever the unconstitutional enactment has violated an express legislation of Congress limiting territorial action, passed under its comprehensive power to legislate with respect to national territory, as the case is with the Organic Act of Puerto Rico. If Congress had legislated prohibiting Puerto Rican taxation of conditional payments, any insular tax upon said payments would have been unconstitutional in the same way that insular export duties on exports from Puerto Rico would be unconstitutional because in violation of Section 3 of the Organic Act. But if such prohibitive legislation does not exist, and a general and comprehensive power to tax has been given the Territory, the constitutionality of the tax cannot be assailed with the commerce clause or any other federal constitutional provision not applicable to the Territory.

But this is not all with the Commerce Clause argument.

Assuming, *argumentatis causa*, that the Commerce Clause extends to Puerto Rico, yet, the tax here involved does not violate said clause.

In order to place the conditional payments under the protection of the interstate Commerce Clause, petitioner characterizes the Victory Tax as a gross receipt tax. Then, he tries to avail himself of a series of cases where it has

been held by this Court that a State can neither lay a tax on the act of engaging in interstate commerce, nor on gross receipts therefrom. See *Crew Levick Co.* v. *Pennsylvania,* 245 U. S. 292; *Gwin, White and Prince* v. *Henneford,* 305 U. S. 434; *Joseph* v. *Carter and Weeks S. Co.,* 330 U. S. 422; *Freeman* v. *Hewitt,* 329 U. S. 249; *Spector Motor Service* v. *O'Connor,* 340 U. S. 602. But, none of these cases, and many others, are controlling here. The taxes in those cases involved were exercises of the nature of business, occupation, license, franchise or privilege taxes based on gross receipts. The Victory Tax is not a gross receipt tax imposed on the privilege of doing businesses, carrying on an occupation or any other sort of privilege, neither is it a license or franchise tax measured by gross receipts. 4 *Cooley on Taxation,* Sec. 1742, p. 3477.

Although the nature of a tax does not depend upon labels, *Spector Motor Service* v. *O'Connor, supra,* it is significant that the Victory Tax Act describes the tax as an "additional income tax" (Section 1). Section 8 (Appendix) provides that "the Income Tax Act of 1924 shall be a law supplementary to this Act in everything not provided for herein." The Supreme Court of Puerto Rico has ratified this description of the tax. *Rivera* v. *District Court,* 62 P.R.R. 491; *Diaz* v. *Tax Court,* 64 P.R.R. 147, 149. While the label of the Legislature is not conclusive, it is entitled to great weight in the absence of language in the statute to the contrary. *Lutz* v. *Arnold,* 193 N. E. 840; *Ingels* v. *Riley,* 53 P. (2) 939; *Porto Rico Telephone Co.* v. *Tax Court,* 68 P.R.R. 144, 147.

It is true that the act also describes the tax as one on *gross income,* but gross income taxes are a thing different from *gross receipt taxes.* The terms "gross income" and "gross receipts" are not synonymous. *Doyle* v. *Mitchell Bros. Co.,* 247 U. S. 179. "Gross receipts" is a broader term, including within it receipts which may constitute capi-

tal as well as income. Mertens, *Law of Federal Taxation*, Vol. 1, Sec. 5.10, p. 187; Magill, *Taxable Income*, pp. 344-347. The direct proof that the Victory Tax is not a gross receipt tax is that it excludes from its scope the income derived from the sale of property which does include returns of capital.

Although the act describes the Victory Tax as a "gross income," is it really that? Section 1 begins permitting a deduction of $15.05 a week. In the case of rents, there shall be deducted also any amount actually paid as interest for liens on the property producing the rent. There shall be deducted also the amounts received as compensation for labor accidents, scholarships, the sums paid by the taxpayer during the taxable year for premiums on his life insurance policies, or on the life insurance policies of his wife or children, and on insurance policies against accidents, or for educational purposes, up to an aggregate insurance of $25,000, the sums obtained or collected on life insurance policies, or on insurance policies against accidents or for educational purposes during the life of the insured, and the sums paid as compensation for cultural or artistic activities sponsored by the University of Puerto Rico or by any organization or association not for pecuniary profit. In the case of contracts for the performance of works, labor, or services, the cost of the materials and labor may be deducted also. In the presence of this panorama of deductions allowed by the Victory Tax Act we can hardly say that the tax is one on gross income.

"Income" is not a rigid term. The difference between "gross" and "net" income is only a matter of degrees. It is now generally agreed that the income tax is not limited to "net income" but may under certain circumstances be imposed upon gross income. The courts have repeatedly viewed deductions as matters of legislative grace, so that

"net income" becomes a statutory rather than an economic concept under which items which might be considered as gross income by the businessman are treated as taxable income by statute. Mertens, *Law of Federal Income Taxation*, Vol. 1, Sec. 5.10, pp. 186-187. This Court has said that: "Unquestionably Congress has power to condition, limit or deny deductions from gross income in order to arrive at the net that it chooses to tax." *Helvering* v. *Independent Life Insurance Co.*, 292 U. S. 371. Thus a categoric distinction between "net" and "gross" income cannot be made. An income can be "less gross" or "more gross," "less net" or "more net," depending upon the deductions allowed by the statutes. The Supreme Court of Puerto Rico, in construing the phrase "gross income", as used in Section 1 of the Victory Tax Act, has acknowledged the allowance by the Act itself of the specific and significant deductions mentioned above and has held to be the duty of the Treasurer to grant all those deductions and exemptions to taxpayers. *Buscaglia* v. *Tax Court*, 69 P.R.R. 93, 104-105.[11] Hence, the Victory Tax, even though described in the act as a "gross income" tax, is more or less a net income tax.

Although, as stated hereinbefore, local taxes measured by gross receipts from interstate commerce have been pronounced unconstitutional, net income taxes have been held by this Court not to burden interstate commerce. *United States Glue Co.* v. *Oak Creek*, 247 U. S. 323.

Something else should be added against petitioner's argument on the commerce clause, assuming, *arguendo*, that said clause extends to Puerto Rico. Petitioner's major

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[11] Petitioner, citing *De Castro* v. *Board of Commissioners*, 322 U. S. 451, says (Brief, p. 15) that "it hardly behooves the Court of Appeals below to hold, as it did (R. 304), that the exaction more closely resembles a net income tax." But the correct thing to say is that the Supreme Court of Puerto Rico has interpreted the tax to be one on gross income less specific and significant deductions, which is just to say a tax on net income. The Court of Appeals is, thus, just ratifying the Supreme Court's holding.

premise is the elementary proposition "that a state can neither lay a tax on the act of engaging in interstate commerce, *nor on gross receipts therefrom*" (Brief, p. 18); his minor premise: that the conditional payments are gross receipts from interstate commerce;[12] his conclusion: that a state cannot [nor Puerto Rico either] lay a tax on the conditional payments. But, for two reasons petitioner's minor premise is erroneous.

1. In order to establish that the conditional payments are gross receipts from interstate commerce the petitioner has had to say that said payments are "the proceeds of sales of sugar grown and produced by petitioner to be sold for immediate and direct shipment in interstate and foreign commerce," that they "are an effective and substantial part of the returns obtained by the producer from the sale of his sugar," and that they are "an amount of money which petitioner received from the Secretary of Agriculture in return for his marketing of sugar in interstate commerce" (See Petitioner's brief, pp. 17-18); but said assertions are unwarranted. If the conditional payments had been proceeds of sales received by petitioner they would have been exempted from the Victory Tax under the specific terms of Section 1 of the Act (See Appendix), and no need would have been of recurring to the commerce clause argument. But the Supreme Court of Puerto Rico held that the payments received by petitioner from the Federal Government were not derived from a contract of sale and consequently were not entitled to exemption under the Victory Tax Act (R. 264-265). This the Court of Appeals below considered a reasonable interpretation (R. 301), and petitioner has not challenged before this Court the Court of Appeals' holding,

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[12] Petitioner does not purport that the Victory Tax is a tax on the act of engaging in interstate commerce.

although he had challenged the Supreme Court's holding before the court below.

That the conditional payments are not proceeds of the sales of sugar clearly comes out from petitioner's own evidence before the Tax Court and from the provisions of the Sugar Act of 1937. The conditional payments were not mentioned anywhere in the purchase contracts of sugar, made between the Commodity Credit Corporation and the sugar mill, as agent of petitioner, and constituted no part of the consideration to be paid by Commodity in exchange for the sugar. (Plaintiff's Exhibits 14, 15 and 16, R. 122-188, admitted at R. 28). The sale was accomplished without the conditional payments. Even though the payments had not been made Commodity would have acquired the sugar by virtue of the purchase contracts. Nowhere from the Sugar Act can be obtained the proposition that the conditional payments are part of the price received by the sugar producers. The payments were received by petitioner solely and exclusively upon compliance with the conditions prescribed by Congress in Section 301 of the Sugar Act of 1937 (R. 39), and they were received by him directly from the United States Secretary of Agriculture by checks from the Treasurer of the United States (R. 40-41, 87), with which the sugar mill had nothing to do as seller and liquidator of petitioner's sugar. Normally the payments were made approximately one year after the cutting of the sugar cane and by this time the sugar might or might not have been sold at the market (R. 42-43). It is significant to note that those payments were estimated on 100% of the sugar produced by the petitioner (R. 47), although 35% of the sugar belonged to the sugar mill under the grinding agreement (R. 38, 47). The payments were determined by the United States Secretary of Agriculture, irrespective of the sugar production and without taking into consideration any of the circum-

stances connected with the contracting, sale, or disposal of sugar. Section 303 of the Sugar Act authorizes additional conditional payments to cover the abandonment of planted acreage and crop deficiencies resulting from drought, flood, storm, freeze, disease, or insects which cause damage to all or substantial part of the crop. As a matter of fact petitioner received conditional payments for sugar which he did not sell, nor even he did produce because of drought (Plaintiff's Exhibit 1, R. 89 and ante, footnote 3). Under such factors it is unjustifiable to consider those payments as part of the price of sugar sold in the market.

In addition, the record shows that even though the sugar produced by petitioner would have been destroyed by fire, hurricane or flood, while warehoused and before marketed, yet he would have received the corresponding conditional payments (R. 73-74, 78). This evidence proves that what made petitioner worthy of receiving those payments was solely his compliance with the conditions of the Sugar Act as a matter of public policy and for the benefit and welfare of the community in general. Petitioner's contention that "no payment can be made unless the producer markets his sugar" (Br. 18) is absolutely erroneous and unwarranted by his own evidence (R. 74).

Petitioner's only basis for his proposition has been an argument on politics and economics. He has tried to arrive at the conclusion that conditional payments are part of the purchase price of sugar by considerations of the historical and economical background of the Sugar Act of 1937 and its political and economic purposes and motives (Br. 17-18). Since the object and purpose of the Sugar Act—the argument goes—is the stabilization of the sugar industry and the restoring of the purchasing power of farmers to a parity level with other producers, "it would seem quite clear that the payments therein provided for constitute in

substance and effect an additional price paid for the sugar produced."

Not in the least underrating the immense value of politics and economics to law and culture, respondent submits that petitioner's above economic and political argument does not warrant the legal conclusion that the conditional payments are proceeds of sale. Economists and lawyers do not seem to have the same point of view in the interpretation of laws. "The legal universe of discourse and the economic universe of discourse are not always the same."[13] "The need for a workable, practicable system of producing revenue necessitates a refusal by the courts to enter into the refinements of economists and lexicographers."[14] Petitioner's proposition is mere speculative theory, inconsistent with the evidence produced and with the provisions of the federal laws. Therefore, the minor premise of the commerce clause argument is erroneous.

2. Even assuming that the conditional payments were part of the purchase price of petitioner's sugar and, therefore, proceeds of the sale of such sugar, yet it by no means follows from this that they were petitioner's *gross receipts* from the sale of his sugar. Petitioner received from the Commodity Credit Corporation, as price of the sugar sold, a basic minimum of 3.46 cents per pound plus an additional subsidy that was to be treated as part of the price. These proceeds did not include the conditional payments and were the larger portion of the total proceeds. On this larger portion of the proceeds no 5% Victory Tax was assessed nor paid by petitioner. The tax was assessed and paid on the other smaller portion of the proceeds which were constituted by the conditional payments. It can hardly be said that a tax has been laid on *gross receipts* from sugar sold

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[13] T. R. Powell: *New Light on Gross Receipt Taxes,* 53 Harvard Law Review 909, 924 (1940).

[14] Mertens, *Law of Federal Income Taxation,* Vol. 1, Sec. 5.03, p. 162.

in interstate commerce when the larger and substantial part of the proceeds were not affected by the tax. The Puerto Rican government did not tax the referred larger portion precisely because it considered it exempt under Section 1 of the Victory Tax Act as proceeds obtained from sales in which petitioner was a contracting party.

Since petitioner's minor premise of the commerce clause argument is erroneous, the argument is illogical and fallacious.

Finally, even if for the sake of argument we accept the conditional payments to have been the total proceeds of the sale of the sugar, and, therefore, the gross receipts thereof, yet the fact should be considered that this Court has held certain taxes on gross receipts not to interfere with or burden interstate commerce. *Western Live Stock* v. *Bureau*, 303 U. S. 250.[15] Respondent submits that under no circumstances the Victory Tax laid upon the conditional payments involved in this case violates the Commerce Clause of the Constitution.

Summary of Point II

The decisions of this Court indicate an increasing disinclination to strike down tax laws of the states on the basis of merely implied constitutional restrictions. The policy to be implied would be one to preserve and recognize, not to strike down, the states' power to tax. Under this policy this Court has held that income taxation on the salaries of federal officers or employees is not illegal under the constitutional doctrine of immunity of the Federal Government

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[15] For recent detailed studies on this problem of taxation of interstate commerce we respectfully refer to: Robert C. Brown, *State Taxation of Interstate Commerce—What Now?*, 48 Michigan Law Rev. 899; Landon G. Rockwell, *Justice Rutledge on State Taxation of Interstate Commerce*, 35 Cornell Law Quarterly 493; Wallace Mendelson, *Recent Developments in State Power to Regulate and Tax Interstate Commerce*, 98 Univ. of Pa. Law Rev. 57.

from state taxation. By the same reasoning, income taxation upon conditional payments obtained pursuant to the Sugar Act of 1937 is not illegal under said doctrine.

Congress has ample power and discretion to grant statutory immunity from taxation to any federal instrumentality. Nothing could have prevented Congress from declaring said conditional payments free from local taxation, but it chose not to do it.

Point II

Although somewhat concealed in between economic concepts around the Sugar Act of 1937 and the Agricultural Adjustment Act of 1938, petitioner's second point of argument is that the Victory Tax Act, in taxing conditional payments, imposes an undue tax or burden upon an agency or instrumentality of the Federal Government. Petitioner contends that the conditional payments are one of the instruments in the Sugar Act devised to carry into effect the declared policy of Congress as to the orderly marketing of sugar in interstate commerce, and that no tax may burden the operations of such instrument.

The contention has been decisively decided against petitioner. *Alabama* v. *King & Boozer,* 314 U. S. 1; *Penn. Dairies, Inc.* v. *Milk Control Commission,* 318 U. S. 261; *Oklahoma Tax Commission* v. *Texas Co.,* 336 U. S. 342; *Graves* v. *N. Y. ex rel. O'Keefe,* 306 U. S. 466; *Rivera* v. *Buscaglia,* 146 F. 2d 461. In *Alabama* v. *King & Boozer, supra,* this Court held that no constitutional immunity of the United States from state taxation prevented a State from applying its sales tax to a purchase of building materials by one who bought them for use in performing a "cost-plus" building contract for the Government, even though the economic burden of the tax was passed on to the United States. In the recent case of *Oklahoma Tax Commission* v. *Texas Co., supra,* after an exhaustive con-

sideration of the question, this Court held that the State of Oklahoma could impose gross production taxes and excise taxes on producers operating on Indian lands, under the jurisdiction of the United States, through contracts that constituted instrumentalities of the Federal Government. According to this case, Congress has ample power and discretion to grant statutory immunity from taxation to any instrumentality it wishes. Its power to determine that a State may not tax a federal instrumentality is absolute, if it keeps within its constitutional scope.

Assuming, *arguendo*, that the conditional payments were an instrumentality of the United States, nothing could have prevented Congress from declaring said payments free from all local taxation.

In the case of Puerto Rico, a dependency of the United States, the federal immunity comes out, not from the mutual respect of sovereigns, as in the case of states, but through the reason that a territory or possession may not tax its sovereign. *Domenech* v. *National City Bank*, 294 U. S. 199. But as it was indicated by the Court of Appeals below in *Rivera* v. *Buscaglia*, 146 F. 2d 461, 463, following this Court's opinion in *Graves* v. *N. Y. ex rel. O'Keefe*, *supra*:

> It may be conceded that the power of a dependency to tax its sovereign will not readily be implied, and that the grant by Congress to the Legislature of Puerto Rico of a general power to tax should not be construed as consent to the imposition of taxes on the United States itself or any of its agencies or instrumentalities. . . . But it by no means follows from this that a further qualification should be read into the broad taxing authority conferred by the Organic Act, so as to exempt the salaries of federal employees from insular income taxes. After all, the ultimate responsibility for the government and welfare of the people of Puerto Rico rests with Congress. In the discharge of this responsibility, Congress has established the insular govern-

> ment. There is no a priori reason to suppose that Congress would not have wished federal employees in Puerto Rico, along with other residents, to bear their full share of the cost of maintaining the local government. . . .

Paraphrasing another very recent federal circuit court's (Ninth Circuit) opinion [16] on a similar question, we may say that by the Organic Act Puerto Rico has been granted the privilege of legislating, including the laying of taxes and the collection of revenue, in much the same manner as a state. And with respect to the states, it is recognized that the successful operation of our federal system can be accomplished only if the state legislature may have reasonable latitude in providing for the collection of revenue from those who are indebted to the state for a measure of protection. And while the state's taxing power must be exercised subject to the limitations set by the due process and the equal protection requirements of the Constitution, the decisions of this Honorable Supreme Court indicate an increasing disinclination to strike down tax laws of the states on the basis of merely implied constitutional restrictions. Illustrative of this tendency are such cases as *Graves* v. *N. Y. ex rel. O'Keefe, supra,* and *Oklahoma Tax Commission* v. *Texas, supra,* both overruling earlier decisions of the Court. These decisions, we think, are illustrations of a general policy of noninterference with the effort of the states to collect taxes from sources within the states. Undoubtedly the United States is concerned with employing and compensating federal officers. The *Graves* case, *supra,* declined to imply from this a prohibition of a state tax on a federal officer's salary. The oil leases on Indian lands considered in the *Oklahoma Tax Commission* case, *supra,* were executed pursuant to the federal policy concerning

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[16] *Alaska Steamship Co.* v. *Mullaney,* 180 F. 2d 805.

the Indians, yet nothing about that policy precluded the state's power to impose a gross production tax on the lessee. Recognition of the state's power to tax was itself a policy entitled to respect. We think any policy to be implied would be one to preserve and recognize, not to strike down, the Territory's power to tax. We know of no Congressional enactment and of no express or implied policy opposed to Puerto Rico's requiring the payment of an additional income tax upon the conditional payments paid in the Island to sugar producers. (180 F. 2d at pages 813-814).

An application of the Victory Tax Act to salaries of federal employees was sustained by the Court of Appeals below in *Rivera* v. *Buscaglia, supra,* and we think that all that was said there, toegther with what this Court said in *Graves* v. *N.Y. ex rel. O'Keefe, supra,* is perfectly applicable to the problem here.

Although petitioner fully realizes the recent restrictions of the concept "agency or instrumentality of the Federal Government" (Br. 24), nevertheless, he tries to distinguish between the conditional payments on one side and the income derived by individuals or firms rendering services on the other. As to the former he says that "a State may not tax the operations of an instrument employed by the government of the Union to carry its constitutional powers into operation"; as to the latter he says that "no particular statutory means or methods are involved, no onerous conditions are to be previously complied with, no stabilization of any industry affecting interstate commerce is concerned, no legislatively devised method to foster commerce and avoid ruinous competition in it is at stake." But, are not the salaries of federal officials or employees, in a more significant way, instruments employed by the Government of the Union to carry its constitutional powers into operation?

In a similar way to the conditional payments, said offices and salaries are created by legislative action, they impose on the recipient onerous conditions, and, verily unlike the conditional payment, their disappearance would put an end to the government itself.

The case of *Kennecott Copper Corporation* v. *State Tax Commission*, 60 F. Supp. 181,[17] cited by petitioner, adds nothing to his contention. The claim made there that the inclusion of the subsidy for war production in the tax base interfered with the war powers of Congress was not passed over by this Court on review. Moreover, the *ratio decidendi* of the District Court was that the subsidy was a gift from the government and not part of sales price and, therefore, should not have been included in fixing amount of occupation tax on gross-sales.

Curiously enough a more recent case has decided that the same subsidy for war production, paid to the same Kennecott Copper Corporation by the United States, pursuant to an order of the Office of Price Administration, should be included, as per determination of local law, in the tax base of ad valorem taxes laid upon the corporation and its properties located in the state. See *Salt Lake County* v. *Kennecott Copper Corporation*, 163 F. 2d 484. In this case the question was specifically raised as to whether the inclusion of the subsidy payments in the tax base constituted taxation of the means used by the United States in the prosecution of the war, and, thus, constituted an undue imposition upon the property or activities of the Federal Government, or any of its instrumentalities. Citing the authority of this Court and referring to the principles hereinbefore mentioned the Court held that "the inclusion of the premium or subsidy payments in the fixing of the tax

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[17] Reversed on jurisdictional grounds in 150 F. 2d 905, cert. granted 326 U.S. 711, affirmed 327 U.S. 573.

base did not amount to a tax against the United States, its instrumentality, its activities, or its property; and it did not contravene any constitutional implication forbidding a tax under state law against the United States or its interests." (163 F. 2d at page 487).

Respondent submits that the imposition of the Victory Tax upon the conditional payments received by petitioner does not burden the Federal Government or its instrumentalities.

Summary of Point III

The imposition of the Victory Tax upon the gross income of individuals and not upon the gross income of corporations and other artificial persons does not violate the equal protection clause of the Organic Act of Puerto Rico. Such classification is not unreasonable. A distinction in legislation is not arbitrary if any state of facts reasonably can be conceived that would sustain it. Two conceivable bases exist which would sustain the Victory Tax discrimination: (1) the Legislature had in mind the difference of treatment which in local taxation was accorded to individuals and artificial entities and was attempting to prevent unequal economic burdens, (2) the Legislature considered the tax measure as an anti-inflation device during the war period, in which device corporations could not take part.

Point III

Petitioner contends that the Victory Tax Act violates the equal protection clause of the Fourteenth Amendment and of the Organic Act of Puerto Rico (Sec. 2, 39 Stat. 951; See Appendix), because it discriminates against him as an individual and in favor of artificial entities.

The constitutional doctrine of the equal protection of the laws as applied to taxation has been so abundantly ex-

pounded by the courts that its principles have been repeated thousands of times.

The power of taxation is fundamental to the very existence of the government of the States. The restriction that it shall not be so exercised as to deny to any the equal protection of the laws does not compel the adoption of an iron rule of equal taxation, nor prevent variety or differences in taxation, or discretion on the selection of subjects, or the classification for taxation of properties, businesses, trades, callings, or occupations. *Tax Commissioners* v. *Jackson*, 283 U. S. 527, 537. The area of permissible legislation for state legislatures is extremely broad. *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435. While it has often enough been recognized that a statutory classification may be so invidious and lacking in rational basis as to offend the constitutional guaranties, the cases are few and far between in which a tax law has actually been invalidated on this ground. In the tax field, more than in any other, legislatures possess the greatest freedom in classification. Since the members of a legislature necessarily enjoy familiarity with local conditions which this Court cannot have, the presumption of constitutionality can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimination against particular persons and classes. *Madden* v. *Kentucky*, 309 U. S. 83; *Rivera* v. *Buscaglia*, 146 F. 2d. 461. If the classification is neither capricious nor arbitrary, and rests upon some reasonable consideration of difference or policy, there is no denial of the equal protection of the laws. *Tax Commissioners* v. *Jackson, supra.* This broad area of permissible legislation of state legislatures and their great freedom in classification, specially in in the tax field, is also enjoyed by the Legislature of Puerto Rico. Its discretion as far as local matters are concerned is not a great deal narrower than that of the state legisla-

tures. *People of Puerto Rico* v. *Shell Co.*, 302 U. S. 253; *South Porto Rico Sugar Co.* v. *Buscaglia*, 154 F. 2d 96, 100.

It has been very well established by this Court that a distinction in legislation is not arbitrary, if any state of facts reasonably can be conceived that would sustain it, and the existence of that state of facts at the time the law was enacted must be assumed. It makes no difference that the facts may be disputed or their effect opposed by argument and opinion of serious strength. It is not within the competency of the courts to arbitrate in such contrariety. *Lindsley* v. *Natural Carbonic Gas Co.*, 220 U. S. 61, 78; *Rast* v. *Van Deman & Lewis*, 240 U. S. 342, 357; *Tax Commissioners* v. *Jackson*, *supra*.

Petitioner seems to be scared at this doctrine, which has been consistently expounded in a long line of decisions of this Court, and forces out the proposition that if there be circumstances which will justify the classification, *it is for the Legislature to point them out*. But this Court has held that a legislature may make distinctions of degree having a rational basis, and when subjected to judicial scrutiny they must be presumed to rest on that basis if there is any conceivable state of facts which would support it. This restriction upon the judicial function, in passing on the constitutionality of statutes, is not artificial or irrational. A state legislature, in the enactment of laws, has the widest possible latitude within the limits of the Constitution. In the nature of the case it cannot record a complete catalogue of the considerations which move its members to enact laws. In the absence of such a record courts cannot assume that its action is capricious, or that, with its informed acquaintance with local conditions to which the legislation is to be applied, it was not aware of facts which afford reasonable basis for its action. Only by faithful adherence to this guiding principle of judicial review of legislation is it possible to preserve

to the legislative branch its rightful independence and its ability to function. *Carmichael* v. *Southern Coal Co.*, 301 U. S. 495, 509; *Madden* v. *Kentucky, supra; Flusbury Hospital* v. *Cass County,* 326 U. S. 207, 215.

The burden is on the one who attacks as invalid a legislative enactment to negative every conceivable basis which might support it. Petitioner has not sustained this burden in attacking the Victory Tax Act as invalid. There are at least two conceivable bases which might support the tax and which have not been negatived by petitioner.

The first one was pointed out by the Supreme Court of Puerto Rico in *Buscaglia* v. *Tax Court,* 69 P.R.R. 93, 103, where the same question was involved. The Legislature might have had in mind the fact that the general Income Tax Act [18] of the Island differentiates between individuals and artificial persons, levying on each of said classes different tax rates and granting to each of them different deductions and credits, the artificial persons having the higher rates and the lesser credits. Furthermore, in addition to the income tax which every artificial person is bound to pay, its component members or stockholders must pay, as individuals, the tax corresponding to dividends or benefits received from the artificial person, which amounts to a double economic burden. Moreover, since the Victory Tax Act taxes dividends from corporations and benefits in partnerships, the imposition of the tax on corporations and partnerships would amount to another double economic burden. It is conceivable, therefore, that the Legislature, in not taxing artificial entities, had in mind the difference of treatment between them and individuals and was attempting to prevent unequal economic burdens.

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[18] Income Tax Act of 1924, Laws P. R. 1925, Sections 12, 13, 18, 28 and 34.

The second conceivable basis to support the tax was already suggested by the Supreme Court of Puerto Rico in *Rivera* v. *District Court,* 62 P.R.R. 491, 510-511, affirmed in 146 F. 2d 461, and was adopted by the court below. The Supreme Court of Puerto Rico pointed out that the apparent purpose of the law, as suggested by the Attorney General, was to serve as a measure tending to avoid inflation during the war emergency. In 1942, when the Victory Tax Act was passed, war was at its height. Military bases were being established in Puerto Rico and existing ones were being enlarged and extended. These activities, together with military conscription, gave occasion for the need of more hands. A great number of laborers were hired and unemployment disappeared. The consequence was that money began to circulate in great amounts, giving rise to a fictitious temporary prosperity based upon an ephemeral economy of war emergency.

On the other side, the staple foods consumed in Puerto Rico came in 1942, from the outside of the Island in a large proportion, and, on account of war, the shipping was limited. Some cargos came to be sunk by the enemies' action. So, we had by one side the purchasing powers of individuals greatly increased for the moment, while on the other side we had scarcity of many staple food items. This situation threatened inflation of the prices of staple foods.

Section 6 of the Victory Tax Act (see Appendix) shows that the Legislature had in mind the above described situation, and that it took into consideration the economic conditions of the Island, when such emergency measure was approved. The tax was to be in force only up to six months after the cessation of hostilities between the United States and Germany, Italy and Japan (See appendix, Section 1). Section 6, together with Section 1, offers a scheme to avoid inflation of the staple foods of Puerto Rico. Since corpo-

rations and other artificial persons were not, as such, consumers of rice, beans, milk, etc., they could not play any part in the plan of anti-inflation. It is true, as petitioner points out, that artificial persons purchase large quantities of staple food products, but they cannot consume, eat, such products, and they just sell them to individuals for consumption. Thus, the individual is necessarily the key of the anti-inflation device. Therefore, in compliance with its purpose, the act could only tax individuals and not artificial persons.

"It is not the function of this Court in cases like the present to consider the propriety or justness of the tax, to seek for the motives or to criticize the public policy which prompted the adoption of the legislation." *Tax Commissioners* v. *Jackson supra;* this Court cannot review the economics or facts on which the legislature of a state bases its conclusions that an existing evil should be remedied by an exercise of the police power. *Central Lumber Co.* v. *South Dakota,* 226 U. S. 157, 158. Deference is due to the judgment of the legislature on the matter. *Dominion Hotel* v. *Arizona,* 249 U. S. 265, 268.

The cases cited by petitioner in behalf of his argument do not run against the validity of the Victory Tax. The circumstances that caused them were absolutely different from those of the case at bar. *Quaker City Cab Co.* v. *Pennsylvania,* 277 U. S. 389, invalidated a tax which could be laid upon receipts belonging to a natural person quite as conveniently as upon those of a corporation. The character of the owner was the sole fact on which the distinction was made to depend. The tax was imposed merely because the owner was a corporation, there existing no rational basis to justify the classification. The same is true with *Frost* v. *Corporation Commission,* 278 U. S. 515, which is not a tax case, but which invalidated a statute that demanded from

individuals, in order to engage in a certain type of business, requirements which it did not demand from corporations, in order to engage in the same business. The distinction was not based upon real or substantial differences having reasonable relation to the subject dealt with by the legislation. But, the circumstances of the case at bar are different, and we have just pointed out reasonable bases for the classification made in the Victory Tax Act.

Petitioner cites as leading the Oregon case of *Redfield* v. *Fisher*, 292 Pac. 813, cert. den. 284 U. S. 617, but the rationale of said case was made to rest on the ground that the tax in question was a property tax and not an income tax. Cf. *Hale* v. *State Board*, 302 U. S. 95, 105. We have demonstrated (Point I) that the Victory Tax was an additional net income tax. It suffices here to say that the proper Supreme Court of Oregon has impliedly repudiated the rationale of the *Redfield* case. See *Middlekauff* v. *Galloway*, 99 P. 2d 24, 26.

More in point to the question involved in the case at bar is the New Hampshire case of *Conner* v. *State*, 130 Atl. 357, where it was held that an income tax upon dividends and interests was not unconstitutional because it failed to tax corporations, since the Legislature had the right to make such a reasonable classification (130 Atl. at page 360).

The indication of the Court below that the distinction between individuals and artificial persons is not unusual in the federal tax structure is supported by cases like *Fort Smith Lumber Co.* v. *Arkansas*, 251 U. S. 532, and *Flint* v. *Stone Tracy Co.*, 220 U. S. 107. Other cases that upheld said classification, although not tax cases, are: *Crescent Oil Co.* v. *Mississippi*, 257 U. S. 129, and *Bain Peanut Co.* v. *Pinson*, 282 U. S. 499.

For the reasons above stated respondent submits that the classification between individuals and artificial persons

encountered in the Victory Tax Act is consistent with the equal protection clause.

Conclusion

The decision of the Court of Appeals as to the taxing act's discrimination between individuals and artificial persons is not in conflict with applicable decisions of this Court and none of the other two questions decided by the Court of Appeals are important questions of federal law which has not been, but should be, settled by this Court. All of the questions raised in the petition can be and were decided by the authority of decisions of this Court for a long time established. Therefore, the writ of certiorari prayed for should not be granted.

Respectfully submitted,

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February, 1952.

DARK PAGE BLEED THRU

APPENDIX

Constitution of the United States of America:

ARTICLE I

* * * * * * *

Section 8. The Congress shall have Power . . .
To regulate commerce with foreign Nations, and among the several States, and with the Indian Tribes;

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ARTICLE IV

* * * * * * *

Section 3. . . .
The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States; . . .

Organic Act of Puerto Rico (Act of March 2, 1917), c. 145, 39 Stat. 951, as amended by the Act of May 17, 1932, c. 190, 47 Stat. 158:

Sec. 2. That no law shall be enacted in Puerto Rico which shall deprive any person of life, liberty, or property without due process of law, or deny to any person therein the equal protection of the laws. (48 U. S. C. 1946 ed., Sec. 737.)

Sec. 3 [as amended by Acts of March 4, 1927, c. 503, 44 Stat. 1418, Sec. 1]. That no export duties shall be levied or collected on exports from Puerto Rico, but taxes and assessments on property, income taxes, internal revenue, and license fees, and royalties for franchises, privileges, and concessions may be imposed for the purposes of the insular and municipal governments, respectively, as may be provided and defined by the Legislature of Puerto Rico; . . .

And it is further provided, That the internal-revenue taxes levied by the Legislature of Puerto Rico in pursuance of the authority granted by this Act on articles, goods, wares, or merchandise may be levied and col-

lected as such legislature may direct, on the articles subject to said tax, as soon as the same are manufactured, sold, used, or brought into the island: *Provided,* That no discrimination be made between the articles imported from the United States or foreign countries and similar articles produced or manufactured in Puerto Rico. The officials of the Customs and Postal Services of the United States are hereby directed to assist the appropriate officials of the Puerto Rican Government in the collection of these taxes (48 U. S. C. 1946 ed., Secs. 741 and 741a.)

Sec. 23. That the Governor of Puerto Rico, within sixty days after the end of each session of the Legislature, shall transmit to the executive department of the Government of the United States, to be designated as herein provided for, which shall in turn transmit the same to the Congress of the United States, copies of all laws enacted during the session (48 U. S. C. 1946 ed., Sec. 842).

Sec. 34. . . . All laws enacted by the Legislature of Puerto Rico shall be reported to the Congress of the United States, as provided in section twenty-three of this Act, which hereby reserves the power and authority to annul the same. . . . (48 U. S. C. 1946 ed., Sec. 826.)

Sec. 37. That the legislative authority herein provided shall extend to all matters of a legislative character not locally inapplicable, including power to create, consolidate, and reorganize the municipalities so far as may be necessary, and to provide and repeal laws and ordinances therefor; also the power to alter, amend, modify, or repeal any or all laws and ordinances of every character now in force in Puerto Rico or municipality or district thereof in so far as such alteration, amendment, modification, or repeal may be consistent with the provisions of this Act.

* * * * * * *

(48 U. S. C. 1946 ed., Sec. 821.)

"An Act to Provide Revenues for the People of Puerto Rico Through the Levying of a Certain Additional Income

Tax Which Shall Be Known as 'The Victory Tax'; to Appropriate Funds for the Administration of This Act, and for Other Purposes", approved December 7, 1942, and amended on May 10, 1943, and May 15, 1943. (Laws P. R., 1942, 3rd Sp. Session, p. 160; Laws P. R., 1943, pages 146 and 630 respectively).

"Section 1. A tax of five (5) per cent upon the gross income of every individual, in excess of fifteen dollars and five cents ($15.05) a week, for interest, rents, salaries, wages, day wages, fees, donations, compensations, remunerations, commissions, premiums, dividends, benefits in partnerships, whether civil or commercial, annuities, and any other income of whatever nature that is in cash, is determinable, and is not obtained from transactions in connection with contracts of purchase and sale in which those who receive it may have acted as contracting parties, or from reimbursements, returns of deposits, liquidations, inheritances, loans, payments on loans, and other similar operations, is hereby levied, and shall be collected and paid in addition to any other tax levied by the Income Tax Act of 1924, and up to six (6) months after the cessation of hostilities between the United States of America and Germany, Italy, and Japan. Without this being subject to interpretation as a limitation of the terms 'salaries', 'wages' and 'day wages', the same refer also to every kind of salaries, wages and day wages paid in Puerto Rico by the Government of the United States of America. In the case of rents, there shall be deducted also as an exemption any amount actually paid as interest for liens on the property producing the rent. Of the income subject to taxation by this Act there shall be deducted also, as exemptions, the amounts received as compensation for labor accidents; scholarships; the sums paid by the taxpayer during the taxable year for premiums on his life insurance policies, or on the life insurance policies of his wife or children, and on insurance policies against accidents, or for educational purposes, up to an aggregate insurance of twenty-five thousand (25,000) dollars; the sums obtained or collected on life insurance policies, or on insurance policies against accidents or for educational purposes during the life of the insured, and the

sums paid as compensation for cultural or artistic activities sponsored by the University of Puerto Rico or by any organization or association not for pecuniary profit. By gross income shall be understood every sum of money derived from the sources above enumerated as subject to taxation which is actually received by the taxpayer, or deposited or assigned in his favor or for his benefit. The word 'payment' as used in this Act shall have also that same meaning:

"In the case of contracts for the performance of works, labor, or services, by 'gross income' shall be understood the difference between the amount finally received by the contractor for the works, labor or services performed and the cost of the materials and labor, without including as part of the latter the salaries, wages or other remunerations credited or paid to the contractor for his personal work. In cases where the tax is to be withheld at its source and when, upon the making of full or partial payments to the taxpayer his actual income can not be determined by the withholding agent, said withholding agent shall limit himself to withholding, until said income is determined, the five (5) per cent tax only on the twenty (20) per cent of the amounts partially or fully paid to the contractors by virtue of the contract. After the works, labor, or service is performed, the contractor shall, on the first income tax return which he renders, set forth his actual income, as above defined, and shall accompany vouchers accrediting the corresponding deductions. This income tax return shall be considered as a claim, according to the provisions of Section 3, when the amount withheld is higher than the amount of the tax payable. The Treasurer may at any time notify the contractor about deficiencies in the payment of the tax if the amount or amounts withheld from the contractor, or the payment which he may ultimately make, do not cover the five (5) per cent of his taxable gross income, as said gross income has been defined above. Said deficiencies shall be collected according to the procedure established in the Act for the collection of the tax.

"The word 'individual' as used in this Act, shall mean a natural person and shall include: Residents of Puerto

Rico, married or single, without application of the provisions of the Civil Code relative to conjugal partnership, and all natural persons residing or domiciled outside of Puerto Rico, whether or not citizens of the United States of America and of Puerto Rico, if these persons receive or are to receive income from any one or more sources listed as taxable in this Act, and said income is derived from causes established in Puerto Rico and the source of payment is located in Puerto Rico.

"The tax levied by this Act shall be collected and paid from and after January 1, 1943.

"This additional income tax shall be known as 'The Victory Tax'. It may be so cited and shall be so cited in the body of this Act."

"Section 6. When the index of retail prices of the staple foods of Puerto Rico, as enumerated hereinafter, reaches the level of the month of June 1941, the exemption established for The Victory Tax levied in this Act shall be twelve dollars and four cents ($12.04) for each week and one dollar and seventy-two cents ($1.72) for each day, when it is proper to compute by days, according to Section 5. The index shall be computed by the Office of Statistics of the Governor of Puerto Rico on the basis of the prices reported by the Department of Agriculture and Commerce. The system of weighted relatives shall be used. The weighting shall be made on the basis of the consumption of these products by the laboring classes of Puerto Rico, as determined through the study of receipts and expenditures of the workmen of the Insular Department of Labor in cooperation with the Work Projects Administration (WPA). There shall be included for the computation of the index the following products: rice, beans, cornmeal, lard, ham, salt pork, codfish, onions, potatoes, plantains, *yautías*, sweet potatoes, milk, coffee, and sugar. The Governor of Puerto Rico shall promulgate, through proclamation, the date on which the prices of these products fall to the level of June 1941."

"Section 8. The Income Tax of 1924 shall be a law supplementary to this Act in everything not provided for herein."